

**EXAMINING THE CFPB'S PROPOSED
RULEMAKING ON ARBITRATION: IS
IT IN THE PUBLIC INTEREST AND
FOR THE PROTECTION OF CONSUMERS?**

HEARING
BEFORE THE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT
OF THE
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U.S. HOUSE OF REPRESENTATIVES
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**EXAMINING THE CFPB'S PROPOSED
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Wednesday, May 18, 2016

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2 p.m., in room 2128, Rayburn House Office Building, Hon. Randy Neugebauer [chairman of the subcommittee] presiding.

Members present: Representatives Neugebauer, Pearce, Lucas, Posey, Westmoreland, Luetkemeyer, Stutzman, Mulvaney, Pittenger, Barr, Rothfus, Guinta, Tipton, Williams, Love, Emmer; Clay, Scott, Maloney, Velazquez, Sherman, Lynch, Delaney, Heck, Sinema, and Vargas.

Ex officio present: Representative Hensarling.

Also present: Representative Royce.

Chairman NEUGEBAUER. The Subcommittee on Financial Institutions and Consumer Credit will come to order. Without objection, the Chair is authorized to declare a recess of the subcommittee at any time.

Today's hearing is entitled, "Examining the CFPB's Proposed Rulemaking on Arbitration: Is it in the Public Interest and for the Protection of the Consumers?"

Before we begin, I would like to thank our witnesses for making themselves available today. And without objection, the Chair is authorized to declare a recess of the subcommittee at any time, and that will be subject to our voting schedule.

Also without objection, members of the full Financial Services Committee who are not members of the subcommittee may sit on the dais and participate in today's hearing.

I will now recognize myself for 5 minutes to give an opening statement.

Good afternoon. Today's hearing will examine the CFPB's proposed rulemaking on arbitration. Arbitration has long been recognized as an important form of alternative dispute resolution for consumers that encourages efficiency, expediency, and lowers the barrier to bring disputes. In fact, in 1925 Congress passed the Federal Arbitration Act, which states that agreements to arbitrate are valid, irrevocable, and enforceable.

Since then, the Supreme Court, on numerous occasions, has upheld the broad use of arbitration agreements in contract law and highlighted the clear Federal policy favoring these agreements.

In 2010, the Democratic-controlled Congress passed the Dodd-Frank Act, which mandated that the Consumer Financial Protection Bureau study the use of arbitration agreements in consumer products and services. Section 1028 requires the Bureau to study these agreements, and then, consistent with the findings of the report, the Bureau may limit or ban these agreements if the findings of the study satisfy two legal standards. Those standards are: Is it in the public interest and for the protection of the consumers?

Last March, the Bureau released its mandated study on arbitration. Unfortunately, rather than performing a thorough analysis of arbitration, as required by the statute, the Bureau instead simply compared arbitration and class action. The Bureau failed to adequately compare arbitration programs across the industry or examine the best practices that produced the greatest consumer outcome.

However, if the congressional intent was for the Bureau to compare arbitration and class actions, the study clearly demonstrates a more favorable outcome for consumers using arbitration as compared to class actions. For example, arbitration produces a significantly higher recovery for individual consumers and has a shorter resolution timeline for recovery.

In testimony before this committee, the agency had stated that banning the use of class action waivers in arbitration agreements, the main provision of the Bureau's rule, would achieve the primary Bureau objective to giving the consumers their day in court.

Actually, nothing could be further from the truth. Let's take, for example, the 2013 U.S. Chamber of Commerce study on class actions. None of the class actions studied ever went to trial before a judge or a jury. Additionally, not a single class action ended in a final judgment on the merits for the consumers.

Now let's compare that to the CFPB's arbitration study. Yet again, we see the same thing. Not a single class action was decided by a judge or a jury. Remarkably, though, class action attorneys recovered over \$400 million in the Bureau's study.

After my own review of the material, I have serious doubts that the Bureau has met the statutory requirements set forth in section 1028. Further, I fear a single unelected Bureaucrat has directed an agency action that is both arbitrary and capricious. The Bureau has failed to articulate a rational connection between the facts found in the May 2015 study and the agency's action before us today.

In my view, the proposed rule is a clear error in judgment by the Bureau. It will perpetuate a justice gap by taking away the legal forum for low-income individuals and those with small and individualized claims. That outcome would certainly not be for the protection of the consumers.

Today, we have a distinguished panel of experts who have spent considerable time studying this issue. I hope our witnesses will walk our members through the Bureau's report and provide their perspective on the proposed rulemaking, including whether the Bu-

reau has satisfied its statutory requirements in section 1028 of Dodd-Frank.

I now recognize the ranking member of the subcommittee, Mr. Clay, for 5 minutes.

Mr. CLAY. Thank you, Chairman Neugebauer.

And thanks to each of the witnesses for today's testimony.

Fair, enabling, cost effective—those are the words that corporate proponents use to describe the arbitration fine print buried at the end of a majority of the financial contracts that American consumers sign. But here is the truth: Adjectives like fair, enabling, and cost effective are false descriptions of what consumers actually experience when they are forced to individually arbitrate their claims against the financial services industry.

Instead, if we want to accurately describe this process, we should be using words like unfair, biased, expensive, opaque, and discouraging. Surely, forced arbitration is unfair when it is shown that consumers win only 9 percent of the time. Surely, forced arbitration is biased when it is shown that consumers recover an average of 12-cents-per-dollar claim while companies recover 98 cents per dollar. Surely, forced arbitration is expensive when, on top of the administrative fee paid by the consumer, forums add on charges like \$1,500 just for a consumer to get a written copy of the decision in their case.

These are the types of concerns that motivated Congress to include a requirement in Dodd-Frank that the CFPB study the impact of the arbitration clauses and how they have impact on the rights of consumers of financial products and services.

These are also the concerns that motivated our decision to empower them, based upon that study, use their rulemaking authority to modify or even prohibit the practice for the benefit of consumers and to protect the public interest.

The proposed rule recently issued by the CFPB does just that, by banning class action waivers in arbitration clauses and increasing transparency through public and government reporting of information on the outcomes of individual arbitration cases.

I applaud the CFPB's efforts in this area and welcome this important proposal to better protect the rights of American consumers.

And, Mr. Chairman, I would like to yield the balance of my time to my friend from California, Mr. Sherman.

Mr. SHERMAN. The choice is not between arbitration and litigation. The choice is between litigation as a class action and absolutely no remedy. When a consumer has a claim of \$10 or even \$5,000, what are they supposed to do? Go hire a lawyer to go through the arbitration process? Who is going to take the case? How much are they going to charge? And if it is a fee for service attorney, how are they supposed to pay for it?

So you cannot compare the litigation process, which is not a joyful experience, versus arbitration. The choice is a class action lawsuit in which a single firm can represent dozens or hundreds of consumers who have been mistreated, or at least believe they have, and no remedy at all. Because I don't think any of our witnesses will be able to identify a law firm that will take, on a contingent

basis, an arbitration claim of a consumer who has been harmed to the extent of \$10, or even to the extent of \$5,000.

The issue here, though, is not just for the litigants involved and the individual consumers. If we create a circumstance in which everyone in the financial services industries knows that if there is a harm to consumers of \$10 or \$5,000 there is absolutely no remedy, then you are going to have—some businesses will change their business model and will say, well, when we take \$10 or \$5,000 per consumer away, it benefits our bottom line, and there is no remedy, the system is broken. If business is going to act in consumers' interests, we need a remedy when it doesn't.

I yield back.

Chairman NEUGEBAUER. The time of the gentleman has expired.

Today, we welcome the testimony of these witnesses: Dr. Jason Scott Johnston is the Henry L. and Grace Doherty Charitable Foundation professor of law at the University of Virginia School of Law; Mr. Dong Hong is the vice president and regulatory counsel for the Consumer Bankers Association; Mr. Andrew Pincus is a partner at the law firm of Mayer Brown, LLP, testifying on behalf of the U.S. Chamber of Commerce; and Mr. F. Paul Bland Jr., is the executive Director of Public Justice.

Each of you will be recognized for 5 minutes to give your oral presentation of your testimony. And, without objection, each of your written statements will be made a part of the record.

Dr. Johnston, you are now recognized for 5 minutes.

STATEMENTS OF JASON SCOTT JOHNSTON, HENRY L. AND GRACE DOHERTY CHARITABLE FOUNDATION PROFESSOR OF LAW, UNIVERSITY OF VIRGINIA SCHOOL OF LAW

Mr. JOHNSTON. Chairman Neugebauer, Ranking Member Clay, and other members of the subcommittee, I want to thank you for inviting me to testify today on the CFPB's proposed rulemaking. I will begin by clarifying briefly what I will talk about, and I am really going to make three points in my testimony.

The first is to set the stage, and it is important that we understand the significance of arbitration versus class actions in creating incentives for firms to avoid wrongful behavior. Then I will talk about the data that the CFPB reported on both arbitration and class actions. Finally, I will make a few comments about how the data was interpreted by the CFPB in its rulemaking proposal of May 5. And then I will conclude.

Now, let me say at the outset that I am not representing any organization. I am here as an individual. These are my views based on research that I have done.

The first point is to understand why the choice between arbitration and class actions matters as much as it does. Accuracy in an ex postdispute resolution system is absolutely crucial to the incentives it creates for firms to avoid harmful conduct. If we have a system, which class actions are, where liability is more or less random and has no relationship in the bulk of cases to whether or not the firm has caused harmful conduct, then we are not creating incentives for firms to avoid the harmful conduct. We are either creating a situation in which firms can't do anything to avoid liability or in which they simply try to reduce the volume of transactions with

consumers who they screen out ahead of time as potentially likely to be part of class actions. Those are not good incentives.

If, on the other hand, we have an accurate ex postdispute resolution system in which firms are made to pay only if they have actually done wrong and caused harm, as arbitration is, you have a good system, you have a system that deters firms from causing harm. So that is why this is so important.

Now, the question is, what did the CFPB study show about class actions versus arbitrations? What it showed about arbitrations is really quite remarkable. It showed, among other things, that 63 percent of the consumers that it studied who filed arbitrations either got a likely settlement or an arbitral award. They did so usually within a really short period of time, 5 months, and the average award was about \$5,400.

It also is important to realize arbitration is cheap, it is informal. Most of these arbitrations are resolved just over the phone or just based on documents. And lots of consumers, the majority had counsel, but you don't really need counsel in arbitration because the CFPB's own numbers showed that consumers without counsel do just about as well as consumers with counsel.

What about class actions? Well, the CFPB has a lot of numbers on class actions, but it is really important to remember that in this rulemaking all of the benefits from class actions that the CFPB advances are based really on one class action settlement—one. They go over and over emphasizing the terms of the settlement in what is called the overdraft fee multidistrict class action litigation. That is their one data point for the argument that class actions actually deter firms from causing harmful conduct. That is it.

And I should note also that as for nonmonetary relief—consumers got money in the overdraft fee litigation—as for nonmonetary relief, the big case there was TransUnion, 350 million consumers, but the relief was what, 6 months of free credit monitoring and 6 months of free credit reports, but credits reports are free anyway under the Fair Credit Reporting Act. That was it.

Now, there is more general data on class actions that the CFPB put in its study, but when you look at the rulemaking, very little is made of the general data by the CFPB. Why? The general data shows that attorney's fees are about 20 percent of the relief that consumers get, and about 20 percent of the consumers in a class actually get any money.

Well, those are not really good numbers if you are trying to argue what the class does is give compensation to lots of consumers at a very low cost. I think, and I won't have time in my first remarks to mention it, based on my own ongoing research, that attorney's fees are much higher on average than the CFPB reported, so the class actions are very costly and a difficult way of awarding compensation and likely not to be a very good instrument of deterrence either.

So the conclusion I have is that if you look at the CFPB's own study it is really surprising that what they are doing is proposing to ban arbitration clauses that prohibit class actions. At most, one would have thought, you know, the bottom line here is more study is needed, we need more evidence, we don't have enough evidence

yet, but the evidence we do have does not seem in any way to support the purported benefits and costs of what the CFPB did.

[The prepared statement of Mr. Johnston can be found on page 102 of the appendix.]

Chairman NEUGEBAUER. I thank the gentleman.

Mr. Hong, you are now recognized for 5 minutes.

**STATEMENT OF DONG HONG, VICE PRESIDENT AND
REGULATORY COUNSEL, CONSUMER BANKERS ASSOCIATION**

Mr. HONG. Chairman Neugebauer, Ranking Member Clay, and members of the subcommittee, thank you for the opportunity to discuss the CFPB's activities related to arbitration agreements for consumer financial products and services. My name is Dong Hong, and I am vice president and regulatory counsel at the Consumer Bankers Association.

CBA is the voice of the retail banking institution, representing 69 depository institutions whose products and services provide access to credit for consumers and small businesses. Our members operate in all 50 States and serve more than 150 million Americans.

Banks have strong business incentives to maintain mutually satisfactory relationships with their customers. When disputes do arise between our member banks and our customers, they are overwhelmingly resolved through informal channels. Only a fraction of the time does a dispute rise to the level of a formal action in court or arbitration. When it does, arbitration is an efficient alternative to litigation.

Since the Federal Arbitration Act was passed in 1925, Federal law has protected—and the Supreme Court has confirmed—the benefits of arbitration as a faster and higher recovery alternative to class action litigation for consumers. On average, arbitration results in nearly \$5,400 in consumer relief within 2 to 7 months.

In contrast, litigation can be complicated, time consuming, expensive, and generally requires a lawyer to navigate. Class actions can take nearly 2 years and result in just 32 bucks on average for the consumer, the equivalent of a tank of gas.

Despite the Supreme Court's support of arbitration and the clear consumer benefits it offers, as noted by the CFPB's own study, the CFPB has issued a proposed rule which could reduce the ability of consumers to take their disputes through arbitration and would subject covered companies to a higher risk of class action lawsuits.

The Consumer Bankers Association believes the proposal fails to provide a sufficient basis for restricting the use of arbitration as required by the Dodd-Frank Act. Specifically, the law directs the CFPB to conduct a study on arbitration relating to consumer financial products and services. It also authorizes the Bureau to restrict or even prohibit the use of mandatory predispute arbitration agreements for such products or services if, and only if, it is "in the public interest and for the protection of consumers" and is consistent with the results of their study.

On March 15, 2015, the CFPB released its study. In its press release, the Bureau was highly critical of arbitration and unabashed in its preference for class action lawsuits. Experts at the Mercatus Center in their independent review found that the CFPB study,

“fails to support any conclusion that arbitration clauses and consumer credit contracts reduce consumer welfare or that encouraging more class action litigation would be beneficial to consumers and the economy.”

While the Bureau’s study is the most extensive arbitration study conducted to date, it remains incomplete and fails to prove that restricting arbitration is in the public interest or for the protection of consumers.

Despite its incomplete nature, the CFPB’s own study shows consumers are better served taking their disputes to an arbitrator rather than participating in a class action lawsuit.

A number of the facts seem to get lost in this debate. The study shows 60 percent of class actions produce no benefits for putative class members. In class settlements that required putative class members to submit a claim form, 96 percent of the class received nothing since they did not file a claim. Consumers obtained cash payouts of a mere 32 bucks on average, and cases took roughly 2 years to settle.

In comparison, consumers who went through arbitration received nearly \$5,400 in cash payments in just a third of the time.

What seems absent from the CFPB study was the full impact of public supervision and enforcement on consumer welfare and protection. The study limits its examination of such regulatory action to the years between 2008 and 2012. This seems to be an odd choice since the CFPB, the agency established to supervise the consumer financial markets, has only been operational since July 21, 2011.

In addition, the study failed to gather any significant data on arbitration settlements, which is a critical element of any fair evaluation of arbitration. To make matters worse, the study shows the Bureau does not have a complete understanding of consumers’ experience with arbitration.

The CFPB is required to provide a sufficient basis for restricting the use of arbitration and must demonstrate that doing so would benefit consumers. It has failed to do so, so far.

Mr. Chairman, thank you for the opportunity to testify. The Consumer Bankers Association appreciates the subcommittee’s interest in the proposed rule on arbitration. We encourage the CFPB to conduct a more complete analysis of this alternative dispute resolution process before finalizing a rule which could seriously harm consumers.

[The prepared statement of Mr. Hong can be found on page 69 of the appendix.]

Chairman NEUGEBAUER. I thank the gentleman.

Now, Mr. Pincus, you are recognized for 5 minutes.

**STATEMENT OF ANDREW PINCUS, PARTNER, MAYER BROWN
LLP, ON BEHALF OF THE U.S. CHAMBER OF COMMERCE**

Mr. PINCUS. Thank you, Mr. Chairman, Ranking Member Clay, and members of the subcommittee. It is an honor to appear before you today on behalf of the U.S. Chamber of Commerce.

I would like to focus on a couple of points. First of all, the Bureau’s study process; second of all, the practical effect of its rule;

and third, address some of the questions about the ability to vindicate small claims in arbitration.

First of all, the study process. Members of this committee, other Members of Congress, interested members of the public repeatedly asked the Bureau for the opportunity to provide meaningful input on this study. Except for a threshold request for suggestions about how to conduct the study at the very outset, there was radio silence from the Bureau for 3 years—no indication of the subjects it was studying, no request for the public to comment, no indication of what topics would be useful.

The result, not surprisingly, is a flawed study that has preordained results that are principally focused on deprecating arbitration and inflating the benefits of class actions. Most importantly, the Bureau never addressed the key policy question underlying its rule: Will consumers be better off if arbitration is eliminated in favor of class actions?

The Bureau probably avoided confronting that question directly because it knows the only possible answer to that is no, as indicated by some of the things my colleagues have said about the relative benefits of arbitration and class actions.

For the CFPB, only the court system will do, even though in the real world the cost, complexity, and crowded nature of our court system makes it impossible for consumers to access courts for the kinds of claims they suffer most.

The facts show that arbitration empowers consumers through the use of technology and gives them the ability to vindicate their rights without dependence on lawyers. So the proposal here will harm the very consumers that the Bureau is charged with protecting by eliminating access to justice through arbitration and relegating them to lawyer-controlled class actions that provide, as you have heard, little benefit to real people, but are great for lawyers. And I have to say plaintiffs lawyers and defense lawyers love class actions.

They will also increase the cost to consumers of financial goods and services without any corresponding benefit, because all of those costs associated with litigation of class actions will, of course, be passed along to consumers.

I think it is important to note that although the Bureau says its proposal is just to require that class actions be permitted, the practical effect of that will be to eliminate arbitration in its entirety because right now companies subsidize arbitration programs. They pay for consumers to file complaints, and the vast majority of arbitration agreements require companies to pay all, or all but maybe 100 or 200 dollars, of all of the costs associated with arbitration.

The Bureau's rule, if it were adopted, would impose on companies the huge defense cost associated with class actions. So the rational company is going to say: Well, if the Bureau is forcing me to pay this money over here, I have to eliminate this voluntary payment over here, much as I like the arbitration system, because I can't do both and keep my costs down. No economically rational company is going to finance two dispute resolution systems.

I think it is important, although arbitration gets demonized, to clarify how it works. It is pretty simple. Parties make common-sense arguments before an impartial decisionmaker. There are not

complicated procedures. You don't need a lawyer. You can file your complaints online, have the decision made based on the papers, based on a telephone conference, or in person at the consumer's option. And as I said, companies pay the cost. The fairness is overseen by the courts, and they do invalidate unfair clauses.

I think we have seen in some of the testimony and certainly some of the debate about arbitration lots of scare tactics about terrible arbitration clauses. The fact is courts invalidate them.

The other important fact is the Bureau didn't even study as an alternative requiring the elimination of unfair clauses or putting some fairness protections in place because it was bent on adopting a rule that was going to eliminate arbitration in its entirety. It didn't even look at those alternatives.

Now, the critical thing about the tradeoff we are talking about is that most of the claims consumers have are individualized: "There was an overdraft charge on my bill. My check didn't get deposited in time. I have a bad charge on my credit card bill." Those are not the kinds of claims that can be brought in class actions. They are exactly the kind of claims that can be brought in arbitration. So by taking away arbitration and leaving people in the hands of class action and class action lawyers, you are significantly reducing access to justice.

One last point, if I may, Mr. Chairman. I am so happy to elaborate on it. There are arbitration clauses, including the one that was at issue in the AT&T against Concepcion case, that provide very strong incentives for contingency lawyers to take even a \$10 claim and litigate it because they get a huge bonus in arbitration if they win. Thank you.

[The prepared statement of Mr. Pincus can be found on page 112 of the appendix.]

Chairman NEUGEBAUER. I thank the gentleman.

And, Mr. Bland, you are recognized for 5 minutes.

STATEMENT OF F. PAUL BLAND, JR., EXECUTIVE DIRECTOR, PUBLIC JUSTICE

Mr. BLAND. Thank you, Mr. Chairman and all the members of the committee, for this honor to appear here.

It is way too common in America for large banks and payday lenders to break important consumer protection laws in ways that cheat people out of money. In my testimony, I describe a series of cases where I represented hundreds of thousands of people who had all been cheated in identical ways out of tens of millions of dollars. In one case, a bank promised all of its customers they would never raise their interest rate over 24 percent, never, and then of course it did raise their interest rates quite a bit more. Another case, payday lenders blatantly violated State laws and significantly overcharged people.

Using class actions, which are often the only meaningful way to actually represent and meaningfully vindicate people's rights, we recovered tens of millions of dollars in refunds. We sent checks to hundreds of thousands of people. We stopped the illegal practices. We erased illegal debts. We got false information off of consumers' credit records.

Now, what the banks are saying to you is that instead of a single case that will resolve all these identical cases in the same way, that instead what would be better for consumers is to be forced to each go it alone on their own.

So if a bank cheated 100,000 people in an identical way, what these guys are saying is the better system is every single consumer has to separately figure out how they have been cheated. So go through their records and figure out what their interest rates were and so forth. Second, they have to go figure out what their rights are under the consumer protection laws. Third, they have to go to the Internet to figure out how arbitration works. Four, they have to file a claim with the arbitration company. Five, they have to pay a filing fee with the arbitration company. Six, they have to take time off of work and arbitrate each case individually for 100,000 people.

Now, if that really was the system, if it was in fact that consumers were going to use individual arbitration, think how unbelievably inefficient that is, the idea that you would have 100,000 people making the identical arguments again and again and again, getting 100,000 different secret decisions in arbitration.

But of course that is not the actual system that we are talking about here. What the banks and payday lenders actually want is for the cases to go away.

What the CFPB study proved is in the vast majority of cases forced arbitration works as it is planned, that consumers can't jump through all the hoops, that cases just disappear.

So I want to give a couple—I have given a couple of examples of cases where I got relief for hundreds of thousands of people. The CFPB study looked at every single case that anyone in America filed in arbitration on an individual basis with the American Arbitration Association over 3 years. In over 3 years, the average total number of cases was 411 for everyone in America for every lender, 411, okay, as opposed to hundreds of thousands of people where we sent them checks and fixed their credit records.

So what the banks and the payday lenders want is they want a system where if they cheat 100,000 people, maybe a couple of them, 3, 4, maybe 5 of them will actually find their way through arbitration, fight their way through, and get a resolution. But the other 99,995 or so, they are going to get nothing.

So it is easy to see why the banks and payday lenders hate the CFPB and spend all this time demonizing the agency with these crazy TV ads and so forth, because the CFPB is saying it is not okay for you to cheat 100,000 people and keep all of the money except for three or four of the people.

And it is the same reason the banks and payday lenders hate the lawyers who represent consumers. So there is all this money demonizing trial lawyers. And what trial lawyers means, it is a code word, it means anyone who represents an individual against a corporation, and so therefore, I guess, you are bad.

If you cut through the smokescreen here, the issue is incredibly simple: Should banks that cheat people be able to use fine print contracts that nobody reads or understands to take away consumers rights to band together?

And the cases I handled are not that unusual. The CFPB study studied over 400 class actions. They found that many millions of consumers, not 411 a year, but millions of consumers recovered more than \$2.2 billion in class action settlements after all the attorney's fees were paid, \$2.2 billion in people's pockets without spending any government money.

Now, the total amount of all the recoveries for all the consumers in individual arbitration in the same period, in 3 years, was 172,000, not million, not billion, 172,000. So you hear all this talk about, well, arbitration is such a great system and consumers really love arbitration, and if you don't let us ban class actions, we are going to take our arbitration ball and go home because we are going to be so upset.

Keep in mind the real truth. The real truth here is that in class actions you actually get millions of people billions of dollars, and in arbitration 411 people struggled through this system, and of the 411 people who went through, only 32 of them actually got rulings from arbitrators. In 3 years, 32 individuals.

So you are really talking about, it is almost like if you had a virus that comes from outer space and it killed 99 percent of all the plants on the Earth. What they are saying is, well, what we should do is we should see whether the 1 percent of plants left are happier after the virus or not, but let's ignore the 99 percent that were wiped away. That is what forced arbitration is doing. It is wiping away nearly all of these cases.

[The prepared statement of Mr. Bland can be found on page 46 of the appendix.]

Chairman NEUGEBAUER. I thank the gentleman.

And now members will be recognized for 5 minutes for questions. The Chair now recognizes himself for 5 minutes.

Mr. Pincus, as you know, the Dodd-Frank section 1028 sets clear statutory thresholds for the Bureau to meet before promulgating a rule. One of those thresholds requires the limitation or ban of the arbitration to be in the public interest. It would appear that congressional action and legal precedent, including a lengthy Supreme Court jurisprudence, has dominated the Federal policy posture to encourage arbitration.

Can you discuss how you see the Bureau's effort with this rule coinciding with the lengthy Federal policy of encouraging arbitration?

Mr. PINCUS. Thank you, Mr. Chairman.

There is 90 years, as you say, of policy and of Supreme Court decisions recognizing the benefits of arbitration. That law was enacted, of course, because of attitudes very similar to the attitude you just heard here. Courts in the 1920s thought they had a monopoly on dispute resolution, and they were angry that arbitration was coming along, and they refused to enforce arbitration agreements in order to keep their monopoly because they thought courts were the only place where you could possibly get the right answer.

And I think what we have learned in 90 years is that is just not true, that arbitration works, and that it is fair. It has to be supervised, but courts do supervise it, and plenty of unfair arbitration provisions are invalidated.

Fast forward to today when our court system is under more pressure than ever because of budget constraints, overcrowding, and a lack of judges, the inability to fill empty seats, and you have a situation where it is critical that there be alternatives that work and alternatives that mean don't work just in the imagination of lawyers at law schools but in the real world. Real people can't take time off to work to go to small claims court to file their claim.

If they can pursue their claim online, if they can have a video—a telephone conference to plead their case and they don't have to take time off for work or leave their kids, that empowers the consumers to vindicate the claims that they care about as opposed to claims that lawyers care about.

Chairman NEUGEBAUER. Thank you.

Dr. Johnston, in your testimony and in your academic work you highlighted an important point I want to explore a little. In the testimony before the committee and in statements in its proposed rule, the CFPB highlighted class actions serve as a deterrent against bad behavior by financial firms. If the Bureau's own study and your scholarship shows that the majority of the class actions in the financial services don't allege individualized harm but rather statutory violations, isn't the CFPB better positioned as an enforcement agency to bring actions for violations of consumer protection statutes?

Mr. JOHNSTON. Yes, I think it is. And I do want to clarify that the unpublished but posted online paper of mine that looks at class actions under Federal consumer protection statutes looks at all class actions, just not those involving the five financial products that the CFPB looked at in its class action study. I do want to clarify that.

But the thing that emerges really from their data set and even more clearly from mine, because I break things down in a much finer way so you can really see what is going on, is when Congress passes a statute and it says to trial lawyers you can create a class of people who get statutory damages of between \$500 and \$1,500 per person without any need to prove harm, and then you aggregate up that class, and sometimes it is on a transactional basis, like under the Telephone Consumer Protection Act, you create an enormous incentive for the plaintiffs bar to go out and find these cases and create these classes and pursue them through class action settlements without regard to what? Without regard to harm.

I mean, this is exactly what you predict from an economic point of view, a class counselor behaving exactly as an economic model would predict. But how does that relate to the public interest and the protection of consumers? There is no necessarily relationship at all. It would be arbitrary. It is wonderful when it turns out that these class actions do involve cases where there is actual harm to the consumer, but that is just happenstance.

The CFPB is an agency that has a lot of information about what is going on out there and it is perfectly situated to make an enforcement decision and a calibrated enforcement decision, an enforcement decision that is based on the agency's determination of the amount of harm being caused to consumers.

So when you talk about the public interest and the protection of consumers, the preference, the tremendously clear preference, as

Mr. Pincus mentioned, of the CFPB for class actions doesn't seem to be consistent with that standard.

Chairman NEUGEBAUER. I thank the gentleman.

And I don't have time to start another question. I recognize the gentleman from Missouri, Mr. Clay, the ranking member.

I will say, right after Mr. Clay's questions, then we are going to recess. They have just called votes.

Mr. CLAY. And I will go through this as quick as possible, Mr. Chairman.

Mr. Bland, Professor Johnston released a paper last week in response to the CFPB's findings where he acknowledges at multiple points that class actions have the ability to benefit consumers by broadly changing industry behavior. Can you provide us with an example of how class action litigation of a small dollar claim was able to shift industry practices to the benefit of consumers?

Mr. BLAND. Absolutely, Congressman.

In North Carolina, payday lending—payday lending is legal in some States. It is illegal in some States. It is regulated in some States. In North Carolina, the payday lenders were operating illegally, and the attorney general told them that, but the attorney general didn't have the resources to go after them. And they just continued to operate despite the fact it was illegal, because they had these class action bans in their arbitration clauses and they thought they were good to go.

When class actions were filed, and this was before the Concepcion case, so if you could prove to a court that the class action ban meant that it was going to gut the consumer protection laws, courts at that time would throw out the arbitration clause. So we got the courts to follow it, and the payday lenders shut down in North Carolina. And what has happened since then in that State is a lot of much better, less predatory, less debt cycle kinds of loans have become available to people. It changed the practice.

Mr. CLAY. It changed the practice.

Mr. BLAND. Absolutely.

Mr. CLAY. For consumers.

I want to ask Mr. Hong and Mr. Pincus a hypothetical. And I know this may be difficult for you to imagine yourself as Mr. Cordray or one of the people at the CFPB promulgating this rule. And on this side of the table, it is up to us as legislators to come up with compromises and to figure out what is in the best interests of consumers.

Hypothetically, where would you find the sweet spot? Where would you find the balance of protecting, and erring on the side of protecting consumers, if you were promulgating this rule?

Start with Mr. Hong.

Mr. HONG. Sure. Thank you for the question, Ranking Member.

One of the things that I found very surprising about the proposal that I looked at from the CFPB is how aggressive it is based upon—the tenor of the proposal seems to be somewhat inconsistent with the study findings that the CFPB has put out.

As I mentioned earlier, I found the study to be one of the most extensive ones ever done on arbitration class actions. But one of the elements that seemed to be missing from that study was how

are consumers—what are their actual experiences with the arbitration process, right.

So the CFPB has not conducted a survey of consumers that have actually gone through class actions or through that arbitration process, so we don't really understand if they are satisfied with those delegants. And another component that was missing from the CFPB study was maybe what the impact of the CFPB has had on the consumer financial markets and compliance. And, you know, the other aspect I was kind of surprised not to see was maybe any consideration of what a cap on attorney's fees might do into promoting consumer benefits on the class action side of the coin.

But going to your question more directly, if I was in Director Cordray's position I would take a more moderate approach with their proposal. I would try to collect more information using their rulemaking authority from perhaps in class action suits and from arbitration.

Mr. CLAY. And keep them both.

Mr. HONG. Yes. And see how that information helps improve their process.

Mr. CLAY. Let me give Mr. Pincus a chance, just quickly, and then we have to go.

Mr. PINCUS. Sure. Thank you for the question.

I think the problem here is arbitration is being ended. And I think the question is, what the Bureau didn't study is: Is there a way to deal with some of the perceived abuses? Is there a way to make arbitration even more user friendly than it is? And is there a way, given the fact that, as Mr. Hong said, the Bureau's study of the relevance of enforcement didn't take into account the Bureau's own existence and its \$660 million budget, to link the Bureau's enforcement authority to claims that people think might be better remedied on some broader basis?

So you could see, for example, a rule that—I think courts already do it, but Mr. Bland worries about fees being charged—that makes sure consumers don't have to pay fees, that has a provision like the AT&T provision.

Mr. CLAY. You are erring on the side of protecting consumers here.

Mr. PINCUS. I am about to get—that includes a includes a provision like the AT&T provision that says if the company settlement offer doesn't make you happy, you get a minimum of \$10,000, double attorney's fees, all your expert costs paid. That is enough of an incentive for any contingent fee lawyer to take the case.

Mr. CLAY. All right. Thank you.

Mr. PINCUS. Then what about saying—

Mr. CLAY. No, thank you. We are going to have to—I yield back.

Chairman NEUGEBAUER. We are going to have to bring this to a conclusion. I am sorry. We will have other opportunities, I think, Mr. Pincus, to do that.

We are now in recess until after votes. I think there are five votes.

[recess]

Chairman NEUGEBAUER. The committee will come back to order. We will resume questioning by our members.

I call on the gentleman from Oklahoma, Mr. Lucas. I recognize him for 5 minutes.

Mr. LUCAS. Thank you, Mr. Chairman.

Mr. Pincus, I am not an attorney by trade, so could you discuss with me for a moment the nature of what some supporters of this rule have argued that arbitration is inherently unfair and deprives consumers of their constitutional rights? And let's talk about—I understand the Supreme Court has ruled on that issue on various occasions. Could you expand on that just a moment?

Mr. PINCUS. Certainly, Congressman. The Supreme Court—first of all, Congress itself in 1925 enacted the Federal Arbitration Act. So it—which specifically—

Mr. LUCAS. So this is not a recent statute on the books. This has been here for—

Mr. PINCUS. Ninety-one years. And that statute says arbitration agreements are enforceable according to their terms unless there is a flaw in them that would make any contract unenforceable. In other words, you can't discriminate against arbitration, which was what was going on. And the Supreme Court in a whole series of decisions has upheld and applied that statute in a whole bunch of contexts, consumer context, employment context, business to business, many, many contexts. So I think the constitutional argument really just doesn't have any—hold any water.

Mr. LUCAS. Can you explain for a moment these rulings have come over the life of the case or early on—or life of the statute or early on?

Mr. PINCUS. There was some early on. There have been a number of rulings in the last, I would say, 10 or so years. There have been a number of cases which the Court has heard on them. After granting review, oral argument, and decision on the merits, there have been a number of arbitration cases where the court has enforced the statute in a summary fashion. It sometimes takes cases just on the cert papers without even—the error of the lower court is so clear that they don't even have to have a full briefing and argument.

So I would say certainly more than a dozen, probably closer to 15 or 20 cases in the last 10 or 20 years applying the FAA.

Mr. LUCAS. So from a layman's perspective, it is fairly hashed-out law? It is not just one ruling. It is not just one decade. It is a well-established set of case law.

Mr. Johnston, can you describe the judicial checks and balances which are in the nature of the arbitration program? Again, to a nonlawyer trying to understand the nature of where we have been.

Mr. JOHNSTON. Well, there are two ways that the fairness of arbitration clauses is ensured. And one is, I guess, you would call it *ex ante*, through the rules that the AAA and the other major consumer arbitral forum have, procedural safeguards that firms, arbitration systems have to meet for them to be willing to arbitrate the claims. And then the other thing is what courts do *ex post*. So if you look at the AAA, American Arbitration Association, which is the one studied by the CFPB, they have a code of procedural fairness that has to be in place before they will accept arbitrations. And among other things, consumers can't bear the fees; they have

to be fair to consumers; the arbitration has to be located within a reasonable distance of the consumers' residence.

And, by the way, the CFPB found that most of the arbitrations it studied were—the arbitration was 15 to 30 miles away from where the consumer was. So it is not like it was across the country and a huge expense to go there or anything like that. So there are these rules that make arbitration fair that the arbitration providers themselves have adopted.

Second, courts have for many, many decades, really, looked very closely at arbitration clauses, and there are certain things that they just won't do, that won't be enforced. Courts have set up very clear rules about certain—what is a fair arbitration clause and what is not. And you see over time that firms that want to actually have an effective arbitration system conform to what the courts say they have to do.

Mr. LUCAS. So, once again, it is essentially a process that has evolved over the decades, well thought out, well discussed, well debated, well considered?

Mr. JOHNSTON. Absolutely.

Mr. LUCAS. I think my questions have been answered.

Mr. Chairman, I yield back.

Chairman NEUGEBAUER. I thank the gentleman.

Now the gentleman from Georgia, Mr. Scott, is recognized.

Mr. SCOTT. Thank you, Mr. Chairman.

This is indeed a very, very important issue, and I want to really get my arms around this. So I really want to hear both sides of this story.

So, Mr. Hong, Mr. Bland, Professor Johnston, Mr. Pincus, could each of you very briefly tell me, in your opinion, what about this did the CFPB get right, and in your opinion, what did they get wrong?

Mr. Johnston, you can start.

Mr. JOHNSTON. I guess I will start, Congressman.

Well, what they got wrong was the evidence that they found does not justify what they did. In fact, when in the body of the rule-making proposal, they start to try to talk about why this is necessary, why they have to ban arbitration clauses that preclude class action relief, they end up saying things like "economic theory suggests," "the expertise and experience of the Bureau with this leads us to believe." There is no economic theory cited by the CFPB. The papers they cite are general. They have nothing to do with this particular issue. And the only evidence that supports what they did—the only evidence they have doesn't support what they did.

Mr. SCOTT. Let me see if I can get more specific here, because I have been looking over this issue. It is a classic issue of arbitration versus class action.

My concern is this, and each of you will—could this rule by the CFPB effectively eliminate the availability of arbitration for our consumers? That is my major concern.

Mr. JOHNSTON. I think it could, and the reason it could—and this is picking up a bit and elaborating a bit on what Mr. Pincus said, I believe, is firms invest in these arbitration systems. They pay consumers' fees. They pay the arbitrators, and even in front of the

AAA. And why would a firm invest in that? And the reason they do so is because they want to make sure that the only kind of claims that consumers can succeed on are ones that are actually valid claims, and therefore, they are going to pay the claims before you ever get to arbitration. If you are going to say that any consumer can bring a class action regardless of an arbitration clause, then why would firms continue to make that investment in a costly arbitration system?

Mr. SCOTT. So to get to your point—I only have 2 minutes. I want to get Mr. Hong as well.

Mr. JOHNSTON. I am sorry.

Mr. SCOTT. So your answer is yes, it could effectively eliminate the availability of arbitration to our consumers?

Mr. JOHNSTON. Correct.

Mr. SCOTT. Mr. Hong, how do you feel about this?

Mr. HONG. I would have to agree with those remarks. As I pointed out earlier, I thought I was very surprised when I saw the proposal from the CFPB, because like I said, based upon the findings and their own study, I thought their position on promoting class action lawsuits was not well supported. And so you could potentially see—if this rule goes final, you could potentially see the class action litigation risk dramatically rise for some financial institutions.

Mr. SCOTT. Okay. Thank you. I want to get the other side of this.

Mr. Bland, do you feel the way, or do you have a different opinion?

Mr. BLAND. This is the scare tactic. It is not true. You look at the securities industry. So if you have a problem with your broker, your broker sells you Enron stocks, you have to go to individual arbitration under FINRA's rules. If you want to bring a class action, you can go to court. FINRA operates exactly along the way that the CFPB is operating, which is to say you can have an individual case in arbitration, let a class action go to court. The securities industry did not take their ball and go home. They didn't say: Oh, we don't want arbitration at all. The only thing we wanted to be able to do is strip people of the right to bring class actions. It didn't happen.

Besides, even if it did happen and individual arbitration went away, then the entire United States, remember, only 411 people a year go into arbitration. The total amount of all arbitration awards for consumers in 3 years is \$170,000. It is not much of a loss.

Chairman NEUGEBAUER. And, Mr. Pincus—

Mr. PINCUS. I think there is about a 99-percent chance that it will go away. In fact, in my testimony, I cite a brief that was filed in one of these Supreme Court cases where businesses explain that that is just what will happen. And to Mr. Bland's example, the reason securities brokers have the system is because FINRA forces them to have arbitration clauses. It is not voluntarily. The rules of FINRA require them to have arbitration and prohibit class waivers. If they had a voluntary option, I think you would see a very different world.

Mr. SCOTT. And so I think, Mr. Chairman, the question really raises itself as to why? Why is the CFPB putting forward this rule as a result of the study? If, in fact, the information that you all have shared is true, that the average return to the consumer for

class action is, somebody said, \$53, whereas the average return under arbitration is \$5,400? Is that right?

Mr. JOHNSTON. That is about right.

Mr. SCOTT. Thank you.

Chairman NEUGEBAUER. I thank the gentleman.

The gentleman from Missouri, Mr. Luetkemeyer, is recognized for 5 minutes.

Mr. LUETKEMEYER. That you, Mr. Chairman.

I am kind of curious. If the gentleman believes that the arbitration goes away, and there is more risk for class action suits, would that not increase the cost of doing business? Would that be a normal thought process, professor?

Mr. JOHNSTON. Yes.

Mr. LUETKEMEYER. Okay.

Mr. Hong?

Mr. HONG. That is correct.

Mr. LUETKEMEYER. Mr. Pincus?

Mr. PINCUS. Absolutely.

Mr. BLAND. No, actually, that is not true.

Mr. LUCAS. Not true?

Mr. BLAND. No.

Mr. LUETKEMEYER. Three to one. You get outvoted.

So if it—

Mr. BLAND. —it happened, and it didn't happen—

Mr. LUETKEMEYER. So if it is the case that is going through as a businessperson, there is more exposure, and it is going to be more cost, then how do you pass those costs on? That means if you are going to have to—you want to continue business, those costs are going to have to be absorbed at some point, have to be reserved for or whatever. Therefore, you are going to have to charge more for your services, I would think.

Also, we are talking about financial institutions here, which means that they are regulated by prudential regulators. That means that there is more risk in the system. So are the regulators going to come down and look at your book of business, complete a different result of this?

Professor Johnston, what do you think?

Mr. JOHNSTON. I don't know if the regulators would, but certainly, there is risk in large class actions. Under the Telephone Consumer Protection Act, for example, some of the largest financial institutions in the country, such as Capital One and Chase, have entered into very, very large class action settlements, many, many millions of dollars. And you add those up across the country and over time, and, again, these are very large financial institutions, so we are not talking about a magnitude of size here that is destabilizing. But it has to fit into the risk profile somehow, and—

Mr. LUETKEMEYER. Mr. Hong.

Mr. HONG. If I could just add to that subject. One of the things that, you know, I fear is that if the proposal goes final the way it looks like today, there is a potential of dramatic increase in class action lawsuit exposures. And if you take a look at some of the prudential regulatory guidance on safety and soundness, one of the things that they ask financial institutions to do is maintain controls and to mitigate the litigation exposure risk. If they see an in-

crease in that type of risk, then they will have to have—you know, institutions will have to have a conversation with the respective financial institution prudential regulator to figure out if they have to hold and walk away more capital to control that risk.

Mr. LUETKEMEYER. Okay.

Mr. Pincus, I see you are chomping at the bit.

Mr. PINCUS. I was just going to make the same point as Mr. Hong, but I will elaborate on it, which is if reserves have to be taken because of the massive class actions, that is obviously capital that is not available to support lending. So that—the only option for the institution is to reduce loans, and it may even have to both reduce loans and find more capital in order to meet these higher capital requirements.

Mr. LUETKEMEYER. Mr. Pincus, in your testimony, I think you were the one that said—you asked the question that CFPB should be asking, is, will consumers be better off with class action lawsuit ability versus arbitration? And then I think you were the one that also came back and said that there are alternatives for arbitration. So I think those two comments, I think, lend themselves to my question, which is: Okay. If they are not better off with this, is there a better way to do arbitration? Are there other alternatives to arbitration versus civil litigation that should be available or could be available?

Mr. PINCUS. Well, I think nobody doubts that arbitration is a superior vehicle for the claims that can't be brought in class actions. It is faster, cheaper, and every study indicates that when you compare apples and apples kinds of cases, consumers do at least as well, if not better, in arbitration. So the whole question here is, is there some kind of case that is going to slip through the cracks because you don't have class actions in court? And I think there are two answers to that.

One is, as I mentioned earlier, some companies have included innovative provisions that provide an incentive for people to litigate in arbitration even the smallest claims. AT&T has this provision, for example, that says—

Mr. LUETKEMEYER. I apologize. I am running out of time here. I have one more comment I want to make.

Mr. PINCUS. Sure.

Mr. LUETKEMEYER. It looks to me as though if you are an individual—and we are talking about financial institutions here now, so if you have a financial institution that took advantage of an individual without the ability to go to arbitration, that individual is left holding the bag, that it really is limited. I asked the question if there are alternatives, and I didn't get an answer to it. There are, apparently, no other alternatives, if you take that away from them, or they go to civil suit. If there are not enough other people that have been offended, you can't go to a civil—a class action suit. So, therefore, I think we have really restricted the ability of the average consumer who is on—in one, maybe for one situation got wronged, to be able to have an opportunity to be righted, have their situation righted.

So I thank the chairman, and I yield back.

Chairman NEUGEBAUER. I thank the gentleman.

The gentlewoman from New York, Ms. Velazquez, is recognized for 5 minutes.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Mr. Bland, would you care to comment on the question that Mr. Scott made before regarding the average reward of \$53 compared to arbitration of \$5,200? Is that comparison unfair, given the fact that the numbers are based on 32 arbitration compared to thousands of litigation cases?

Mr. BLAND. And that is absolutely right, Congresswoman. You could not be more correct. It is not just an apples and oranges comparison. It is like comparing frogs and ball bearings. They are completely different.

There are types of cases which can't be brought as a class action: if someone is individually defrauded, someone does something that is going to make you lose your home, something like that.

The numbers that they are using as being such a big number, supposedly, that people are getting in arbitration, it was 15 percent of what the consumers asked for. So if a consumer came in and asked for \$100,000, saying that they have been defrauded, they are only getting \$15,000. So the idea this is a great deal is really not fair.

Ms. VELAZQUEZ. Thank you, Mr. Bland.

And can you explain how class action provides a more effective means of securing significant consumer relief and changing a company's potentially illegal behavior than an individual formal adjudication or informal efforts to dissolve disputes?

Mr. BLAND. Yes, of course. Not only does the class action deal with everybody in the class—so if 100,000 are cheated, all 100,000 get a remedy—also, there are a lot of types of scams in which the vast majority of consumers won't detect them. So I described in my testimony, we had a case in which American Express was underpaying people on rebates. They promised people you would get a rebate on your charge card of up to 5 percent. So our client is a bookkeeper who figured out and went and did all the math to figure out how he was cheated, but almost no other consumers would do that. So what happened was, when the case was thrown out because of the arbitration clause, they simply get to keep all the money. They walked away without paying anybody anything.

Ms. VELAZQUEZ. And as a followup, can you explain how arbitration agreements are being used by companies to block a significant portion of class action claims that are filed and suppressing the findings of others?

Mr. BLAND. That is the entire reason that the arbitration clauses came out, was because they were trying to block cases. So, for example, in the early 2000s, there was litigation against auto finance companies, which showed that over many millions of people, African Americans were being charged twice as much as White people in order to get on finance charges to borrow on a car. And so there was litigation in these class actions that got that changed, that got injunctive relief to change that for everybody, and that is when the auto finance companies leaned on the car dealers, and you suddenly saw the arbitration clauses that banned class actions everywhere, was precisely because they had been effective.

Ms. VELAZQUEZ. Thank you.

Mr. Hong, proponents of arbitration support its use, because they say it provides a quicker resolution on a lower cost to the consumer. Has the use of arbitration reduced the price and expanded the availability of credit for consumers?

Mr. HONG. I thank you for the question, Congresswoman.

So when you take a look at the CFPB's own study, you will see that consumers are actually benefiting through these arbitration processes. And so, you know, you have to ask yourself, if a company is forced to lock away capital that can't go for useful purposes, is that a net benefit for consumers? You know, is the lack of innovation or ability to innovate and produce more tools and services for consumers a win for consumers? And I have to say that is incorrect.

Ms. VELAZQUEZ. Mr. Bland, will you comment on that?

Mr. BLAND. Yes.

There is really not an innovation here. The use of the arbitration clause is just a use of power right now. There are companies who simply want to be able to break the law and get away with it. And what they want to do is they want to be able to opt out of the civil justice system and just sort of give themselves a get-out-of-jail-free card. It is not a particularly imaginative, creative, or unusual thing. It is not like we are talking about devising a new way to get to Mars or something like this. These are fine print contracts that are sent past consumers in ways that almost nobody reads, almost nobody understands, but they strip people of their important rights to be able to protect themselves, and they gut the enforcement of the consumer laws.

Ms. VELAZQUEZ. Thank you.

I yield back.

Thank you, Mr. Chairman.

Chairman NEUGEBAUER. I thank the gentlewoman.

Mr. Rothfus is recognized for 5 minutes.

Mr. ROTHFUS. Thank you, Mr. Chairman.

I have a couple of questions for Mr. Hong. Has the Bureau ever approached your members and the Consumer Bankers Association to discuss potential ways that the current arbitration system could be improved, or did the agency undertake this process already knowing the end in mind, and that is ending arbitration?

Mr. HONG. Thank you for the question. So we have had multiple opportunities to engage with the CFPB in this rulemaking process. Early on, during the RFI process that the CFPB put out, what they were trying to think through exactly what they should be studying, we made similar comments that we—I have made today about the need to get a comprehensive study done before they make any decision on rulemaking.

And so, you know, I was very surprised when I took a look at their study, and I didn't see any of our recommendations go through.

Mr. ROTHFUS. Did the CFPB respond to your entreaties?

Mr. HONG. No. You know, we have had discussions with them, and we have made suggestions again and again. And often I just don't see where the dialogue has led to any results, and I didn't see that in the study itself.

Mr. ROTHFUS. Would your members be willing to work with the Bureau to improve financial literacy among consumers concerning arbitration and, if necessary, improving how information is communicated to consumers about when they are agreeing to arbitration when choosing among products and services in the marketplace?

Mr. HONG. Absolutely.

Mr. ROTHFUS. But the Bureau never had that kind of discussion?

Mr. HONG. You know, that is one of the things that came out of the study pretty clearly, that consumers do not have a full understanding of arbitration. And we have suggested to the CFPB that they should use their authority and powers and the funding at their disposal to do more to educate consumers about the benefits of arbitration.

Mr. ROTHFUS. The Bureau did not respond to that?

Mr. HONG. I have not heard a response yet.

Mr. ROTHFUS. Well, it ties into another question. The Bureau clearly believes that class action lawsuits are necessary to deter companies from violating the law. However, the Bureau itself was created—and I am quoting directly from the Bureau’s own website here, “to provide a single point of accountability for enforcing Federal consumer financial laws and protecting consumers in the financial marketplace including, quote, ‘rooting out unfair, deceptive, or abusive acts or practices by writing rules, supervising companies, and enforcing the law.’”

Isn’t the Bureau’s position on the need for class action lawsuits to deter bad behavior also an implicit admission that the agency is failing in its other duties?

Mr. Hong?

Mr. HONG. So, you know, one of the things that I do think that there is a big gap in the CFPB study here is the fact that, as I mentioned, in some earlier remarks, I thought the Bureau really should supplement their report by including their own impact on consumer financial markets. Since they closed the study during the year 2012, that means that most of the activities that the CFPB has engaged in have not really shown up in the research. And so I would suggest to the CFPB that more research needs to be done in this particular area before they engage in any rulemaking on the benefits of arbitration.

Mr. ROTHFUS. Mr. Pincus, I am particularly concerned about the practical impact that the Bureau’s proposed rule will have on consumers, both those trying to vindicate claims and those who are simply trying to obtain products and services in the marketplace.

With respect to the former, I worry that, contrary to what the Bureau claims, the proposed rule will disproportionately harm lower income consumers by eliminating, rather than enhancing, avenues of resolution by increasing the costs to bring a complaint.

For example, there is generally no financial barrier to arbitration proceedings because the programs are often subsidized by the companies. However, the Bureau’s rule will essentially end arbitration and force consumers to seek individual resolution paying costs out of their own pockets because most claims will be too small to attract the attention of the trial bar. Where does the Bureau expect these consumers to go to obtain relief?

Mr. PINCUS. I don't know, Congressman. This really is about selling out consumer empowerment and favoring lawyer empowerment.

Mr. ROTHFUS. Because there are going to be many claims that the consumer might have that are not going to fall within the class action metric, whether numerosity, commonality, whatever. So is that consumer left having to retain an attorney?

Mr. PINCUS. That consumer is left with no good choices, having to retain an attorney, but as you say, the claims are going too small. As I note in my testimony, most studies indicate the amount at issue has to be at \$200,000 to attract contingent fee lawyers these days, or the consumer is on his or her own with complicated procedures, having to take days off of work to deal with overcrowded courts. They are not going to do that. So they are just going to be left with no real avenue to vindicate their claims.

Mr. ROTHFUS. And I would suggest that might be more difficult and complicated than looking at arbitration provisions. Yes?

Mr. PINCUS. Absolutely.

Mr. ROTHFUS. I yield back.

Chairman NEUGEBAUER. The time of the gentleman has expired.

The gentleman from Washington, Mr. Heck, is recognized for 5 minutes.

Mr. HECK. Thank you, Mr. Chairman.

I would like to ask all the witnesses to answer this question, perhaps beginning with Professor Johnston and going down the line.

It seems like there are two large points being made here. One is that arbitration is more efficient and less expensive. Another is that acting as a class allows a more efficient way of dealing with lots of similar kinds of claims.

So what is the argument against classwide arbitration? Why should or would contracts bar that?

Mr. JOHNSTON. I would—the problem with classwide arbitration is that there is no way to do classwide arbitration without replicating the procedural complexity and cost of class actions in actual court. And since the entire point of arbitration is to have a simple, low-cost, and accurate system, you wouldn't be realizing those benefits through classwide arbitration.

Mr. HONG. I would agree with those remarks. Talking with our membership, they find that—you know, they created that—you know, they participate in the arbitration system to provide an informal convenient hearing forum for their consumers. And so to input a classwide system into the arbitration system, I don't think is a natural fit for that particular forum. And I don't think many financial institutions or other companies would be willing to give up the protections—some of the protections that the litigation rules would apply in a classwide setting.

Mr. PINCUS. I agree with my copanelists. And I would say I think in the balance that you are suggesting, one question that has to be asked is, what are class actions really providing? And when the Bureau itself finds that 87 percent of them result in zero benefit to the class and the ones that—the other 13 percent that are settled, only about 4 percent of the class members pick up a check, I think it tells you that they are not providing a lot of benefits. And I think to the extent they are, I think, as some other members of

the subcommittee have said, the question is, isn't the Bureau supposed to address just those kinds of cases, where there are broad impacts on a lot of people through either its enforcement or its supervisory function?

And it is a shame that the Bureau's study was sort of purposefully, I think, cut off so that it couldn't examine the overlap between its enforcement authority and class actions, because it stopped the study before its enforcement authority got up and running. But it seems to me that is exactly what Bureau is supposed to focus on, practices that have a broad impact on a lot of people.

Mr. BLAND. Congressman, I would say that actually you have a bunch of class actions in arbitration that worked perfectly well, and there were some cases that got millions of dollars distributed to consumers on class actions that were handled in arbitration and run by arbitrators. The American Arbitration Association set up special rules for how class actions could be handled. And there have also been some class actions and arbitration that led to injunctive relief, that led to significant changes that stopped illegal practices by companies.

I think what you are hearing is that the purpose of these arbitration clauses is not actually to have a case in arbitration, because arbitration can handle class action as well as the court pretty much, and you still have some judicial review in the end. What you are hearing is that they want to make sure that if they cheat 100,000 people, that only 5 of them are going to show up or something like that. They don't want to have a system in which if you cheat 100,000 people, all 100,000 of them can actually get a remedy, which is what a class action arbitration would create the possibility for.

Mr. HECK. Mr. Bland, are you suggesting that the National Arbitration Association, or whatever it is called, actually has rules, guidelines, and/or structure for classwide arbitration?

Mr. BLAND. It absolutely does, and there have been quite a few cases. And I have handled arbitrations on a class action basis myself.

What you see, though, is that the vast majority of companies in their fine print contracts banned the consumers from going on a class action basis in court or in arbitration. They say you can just never have a class action. They are actually willing to let you go to court for small claims court. The one thing that they are trying to do is make sure that each individual consumer is atomized and isolated.

Mr. HECK. So I have just one last question. It is my recollection, please correct me if I am wrong, that the inclusion of class action waivers began approximately within the last decade? And on the happy assumption that that is correct, can anybody cite any studies, research, analysis about a material drop in cost to consumers, because there can be no other conclusion if you are suggesting that that which existed for all time was stopped but was now to be returned would increase, significantly increase, cost and product availability? I am assuming somebody documented that costs went down and product availability went down?

Mr. PINCUS. Well, if I can respond to that. The reason there is no such study is that it wasn't until the Concepcion decision, which

was just 4 years ago, that it was clear that those arbitration clauses could be enforced. In many States, like California, they were not enforced.

Mr. HECK. So there has been no verification that it has resulted in reduced costs?

Chairman NEUGEBAUER. The time of the gentleman has expired.

Mr. HECK. Thank you, Mr. Chair. I yield back the time I clearly don't have anymore.

Chairman NEUGEBAUER. I thank the gentleman.

And I now go to the gentlewoman from Utah, Mrs. Love, for 5 minutes.

Mrs. LOVE. Thank you.

I have been in and out of votes, and this question may have been covered. And if it has, I apologize. I certainly think it is worth repeating, if it has been.

But I wanted to ask a question to Mr. Hong. Can you tell us a little bit about how your member companies have set up the arbitration process and what that looks like for a consumer?

Mr. HONG. Well, if you wouldn't mind, if I took a step back and just talked a little bit more broadly about how financial institutions deal with disputes more generally? Would that be—

Mrs. LOVE. If you can do it in a quick manner, that would be easiest. Obviously, I know it is complicated, but go ahead.

Mr. HONG. Okay. I will try to be quick. So the banking industry is a customer service business. So the primary function that you should think about, all of us should think about, is that financial institutions have business incentives to keep their customers happy.

The second line, layer, that you will see in dealing with disputes is the compliance management systems that financial institutions are required to keep, you know, to ensure that they comply with the law. And on top of that, they have devoted millions of dollars in their consumer dispute resolution processes to ensure that they can cover those types of disputes that might pop up every now and then between a business and a customer.

Mrs. LOVE. Right.

Mr. HONG. For the institutions that offer arbitration, you know, they believe the arbitration provides a better forum for their consumers to have their stories heard by a mutual third party. And so, you know, when you take a look at the process, you see a lot of—a majority of financial institutions use American Arbitration Association to provide that forum. And I believe that the CFPB study has shown that consumers are doing well through that process.

Mrs. LOVE. Okay. So, in other words, I mean, you mentioned customer service, business-oriented. Obviously, customer retention is a big issue in making sure that their customers stay with them.

Mr. HONG. That is right.

Mrs. LOVE. Okay. So a followup question to Professor Johnston. It is my understanding—sorry. I can't see you. But it is my also my understanding that in many class action cases that are filed, there is just a statutory violation, no actual harm to consumers.

Can you explain that for me a little bit?

Mr. JOHNSTON. Well, many of—yes, Congresswoman. I can, and I am happy to do so.

Many of the consumer protection statutes under which the class actions in the CFPB's study arose and in my more recent and more comprehensive study, those statutes award statutory damages without proof of harm for a violation.

For example, the most common Fair Credit Reporting Act kind of case, in my sample, and probably the CFPB's—although, it is hard to say, because they don't break things down at this level of detail—is a case alleging that the expiration date was printed on a credit card receipt. There is the four digits. You can print the four digits of a credit card but not the expiration date, despite years and years and years of evidence that there is no increase in the chance that somebody's credit card information, you can figure it out just because the expiration date is there. These cases are brought all of the time.

Mrs. LOVE. Yes.

Mr. JOHNSTON. These are credit card cases that also would appear in the CFPB's database, which by the way, for the very first time, we can actually—after they promulgated this rule, this is the first time they have even given us a list of the class actions that they have studied. Up until now, they have viewed—this is supposedly evidence-based policy, right? Well, up until now, they have viewed this as sort of like secret data that no one gets to see.

Mrs. LOVE. Okay. I would assume that that information would be important?

Mr. JOHNSTON. I am sorry?

Mrs. LOVE. I would assume that that information would be important?

Mr. JOHNSTON. Yes, absolutely. My point is this is a typical kind of case that would be in their database and my database. And it is really important to look at a big sample of class actions and class action settlements, because when you do, you see that the cases that Mr. Bland is talking about—I am not denying their reality, but they are few and far between.

Mrs. LOVE. Okay. Okay. One more question.

Mr. PINCUS, you mentioned in your testimony that arbitration consumers aren't reliant on hiring lawyers. In other words, they can seek redress on their own through arbitration process. I heard through other testimony that they have to go through and understand the arbitration process, and that is a difficult process to understand. Can you just talk about that just a little bit? I only have 10 seconds, but I just wanted to—

Mr. PINCUS. There is an online—almost everything is online these days, including arbitration provisions and how to use them. So the AAA, we have been talking about the American Arbitration Association, has very understandable procedures for consumers to use if they want to file—commence an arbitration proceeding.

Mrs. LOVE. Thank you.

Chairman NEUGEBAUER. I thank the gentlewoman.

The gentleman from Georgia, Mr. Westmoreland, is recognized for 5 minutes.

Mr. WESTMORELAND. Thank you, Mr. Chairman.

And before I begin, I would like to ask unanimous consent to submit a letter to the record from the Electronic Transactions Association.

Chairman NEUGEBAUER. Sorry?

Mr. WESTMORELAND. Okay. I would like to ask unanimous consent to submit a letter for the record from the Electronic Transactions Association.

Chairman NEUGEBAUER. Without objection, it is so ordered.

Mr. WESTMORELAND. I have used 30 seconds of my time already.

Mr. Bland, just a couple of questions. I noticed your history of lawsuits on the back here suing these, I guess, various banks in some form or fashion. Do you remember what your total fees were when you would sue a bank? I mean, was that a percentage, or who paid you, and who were these suits on behalf of?

Mr. BLAND. So every case that I have handled where we have won and received a settlement, we have gotten some attorney fee—I mean, I am with a nonprofit. But we have received some attorney fees based on a percentage of what we recovered.

For example, in the case against Chevy Chase Bank where they misled people about their credit cards, we got a \$16.1 million recovery. I think the attorney fee in that case was 20 percent. It was approved by a court. There was a big argument about whether that was fair. We had to come in and show that we worked more hours and that it was based on a percent.

In the cases in North Carolina involving payday lending, on my resume, where we recovered \$45 million for consumers and sent it out in checks, I think in that case the court approved a 30 percent fee in the first case because there was a lot of work and, in the other cases, approved a lower percentage. I think it was 25 percent and was approved by a court, and there was a lot of debate and discussion about it. So it is generally done on a percentage of the case. But then you also have a cross-check of what your hours are. So before a court will approve it—you can't just come in and say: I want 20 percent, you know, of whatever.

Mr. WESTMORELAND. I assume part of your cost is mailing out all these letters to the different people. I get a letter almost once a week asking me to join some type of class action lawsuit. Is that what you do, solicit business that way?

Mr. BLAND. No. I have never engaged in advertising. People come to us and ask—

Mr. WESTMORELAND. Well, that sounds like pretty good pay for a nonprofit. But, you know, I just had a case where I had a problem with a charge on my credit card. I called, told them what the problem was.

And she said: Well, I am sorry you didn't read the fine print, whatever.

I said: Fine. I am just going to take it to the credit card company.

I was talking to the retailer. And they said: Well, would you pay 30 percent?

And I said: Yes, I would.

And so she said: Do you agree to that knowing blah, blah, blah, blah?

I said yes. So we settled it, because it was a misunderstanding.

And this class action thing, to me, is taking that right away from somebody that is trying to do something or arbitrate or mediate their problems. But whether it is a woman trying to get—that is got an error on a \$25 prepayment card or small-business owners, if any of these situations—I would like to get my problem solved as soon as possible so I could go ahead and pay my debt.

Professor Johnston, I know you have looked at data on how companies handle customer issues. Can you describe why companies may want to resolve a claim quickly?

Mr. JOHNSTON. Yes. The reason is, by sometimes admitting they made a mistake and refunding a charge, what the companies do, they basically make their customers happy; they do the right thing, and that builds business.

The CFPB, in the report, in their study, and also in this proposed rulemaking, continually asserts that the only reason a company would ever refund a charge is because it is a super profitable customer.

Now, this assumes that they have really, really fancy algorithms or something. But the important point for present purposes is the CFPB has no evidence of that. They simply say, they assert, economic theory suggests that the only reason you would refund a customer is because profitability demands it. In the CFPB's world, fairness to consumers is opposed to profitability. In the real world, as far as we know, by being fair to consumers, companies build profitability.

Mr. WESTMORELAND. Well, that seems to be the CFPB's MO.

Just to make sure, Mr. Pincus, you mention in your testimony: But not every problem or claim like the ones I just mentioned are able to join a class action lawsuit.

Is that correct?

Mr. PINCUS. That is exactly the problem. Those people—those claims are individualized, and so they can't be litigated in class action.

Mr. WESTMORELAND. Unless somebody like Mr. Bland mails them a letter and asks them to join a class action lawsuit, because they may not even know there is a class action lawsuit?

Mr. PINCUS. Although even if they do, the court will likely—that will be one of the 87 percent that is thrown out, because it is not common—it is not a common issue among a lot of people. It is your particular problem that you want to resolve, but isn't common to the other 100,000 people or whatever it is.

Mr. WESTMORELAND. Thank you, sir.

And I yield back.

Chairman NEUGEBAUER. Let the record reflect I gave the gentleman his 30 seconds back.

I now yield to the gentleman from California 5 minutes.

Mr. WESTMORELAND. I tell you what; I am just going to be a sport and just yield it back.

Mr. SHERMAN. Mr. Johnston, I think you are right, an awful lot of companies hear complaints, make an allowance, but that doesn't mean we don't need a CFPB and a court system for those companies that don't or those consumers who are unaware. I think that if you were to send out bills to a lot of, you know, credit card holders in my district, and it said, "We are charging you 18 percent,"

but the computer was programmed to charge them 22 percent, very few of my constituents would whip out their financial calculators and realize that they were being charged more.

So there are times when the consumer doesn't know, and there are times when the company will not make an adjustment.

Mr. HONG, I think, in my opening statement, I laid out the fact that you can't just deal with these matters one at a time. If you have a bunch of consumers, each one of those lost \$100, there is no lawyer who is going to represent them one at a time.

Does your organization support a requirement that if there are arbitration clauses imposed on the consumer, that they provide for class action arbitration so that when there are 1,000 consumers, each one of whom \$50, that some lawyer can bring the action?

Mr. HONG. I thank you for the question, Congressman. So the first point I—

Mr. SHERMAN. I mean, that was really just a yes-or-no question. I have very limited time.

Mr. HONG. I would suggest that the CFPB examine that issue by doing, conducting supplemental research, which is what we have been asking them to do. Maybe they can study the effectiveness of doing, conducting class arbitration.

Mr. SHERMAN. Would your organization fight against a rule that required that whenever there was a financial services company that had an arbitration clause in their provision, that they provide for class action arbitration?

Mr. HONG. What we want is the same thing that Congress asked—

Mr. SHERMAN. I am just asking, what is the position of your organization? Because you can come here and fight against the rule but also fight against class action arbitration.

Mr. HONG. What we asked for is the same thing that Congress has asked the CFPB to do, which is to study that fairly excessive arbitration.

Mr. SHERMAN. Okay. So, right now, you retain the freedom to fight against any kind of class action arbitration or class action lawsuit. And I will point out, according to the material I have here, there have only been 32 relevant arbitrations in the whole country for a number of years, which proves that one case at a time is not going to do the job.

Mr. Bland, there is this idea that consumers will know that they have been taken advantage of. Again, I think I could—you could probably—you could send out statements charging 22 percent interest and put in big letters, "We are only charging you 18 percent interest," and maybe all the CPAs in the district might notice, probably not even there.

So other than finding out that there is a class action lawsuit, how is an individual consumer supposed to know that they are being taken advantage of?

Mr. BLAND. You are exactly right, Congressman. The vast majority of the time, scams are cleverly done in ways that most consumers won't pick up, both for the kind of reason that you give, but also a lot of the people don't know what their legal rights are as well as calculating interest rate.

So, for example, with the payday lenders, who are operating illegally in a number of States, they are operating with stores. They get someone with a name tag on their shirt. The consumers go in there, and they don't realize what the usury State laws are and so forth. So your point is true both from a matter of fact and from a matter of law. Consumers don't know what their rights are, and that is one of the reasons why class actions can be so crucial.

Mr. SHERMAN. One argument made by those in support of this, because I think if you just had arbitration, you are basically saying there is no private right of action, is that the CFPB should be the police person, not the trial bar.

Is the CFPB cable of creating a system of fairness such that no financial institution would ever do anything that is harmful to consumers and, if they did, that the CFPB would recover, and we wouldn't need any private trial lawyers?

Mr. BLAND. They clearly do not have the resources to replace private enforcement of rights. I mean, I think it is a great agency. I think they are doing terrific enforcement work, but they are getting so many calls from people that they only have so many people they can handle. And a lot of the cases that are being filed by private individuals who feel that they have cheated been are ones where they couldn't get someone at the CFPB, because the agency was too busy.

Mr. SHERMAN. Let me point out, the tip of the iceberg is when, any kind of case, arbitration, litigation, governmental enforcement is there. The number one reason for this is to make sure that care is taken at every financial institution not to do anything wrong. And 99 times out of 100, they don't do anything wrong, and you are part of what inspires that care.

I yield back.

Chairman NEUGEBAUER. The time of the gentleman has expired.

I now recognize the gentleman from New Mexico, the vice chairman of the subcommittee, Mr. Pearce, for 5 minutes.

Mr. PEARCE. Thank you, Mr. Chairman.

Mr. Hong, you have heard—I mean, I am sure you read the testimony, and Mr. Bland mentioned several times, that only 411 cases have really gone to arbitration. So why is that number low? Do you have anything in your experience that would indicate that?

Mr. HONG. So it is in the interest of the financial institutions to keep their customers satisfied. So that is—the primary thing we should keep in mind is that this is a business, and it is a customer-centered business that is very competitive with over 6,000 banks in the United States.

Mr. PEARCE. Okay. So it is in their interest.

Mr. Bland, as I am reading your report, I see on page 12 that you had a case settled with Wells versus Chevy Chase Bank. You settled for \$16 million. Basically, if you could describe for us, what was that money for?

Mr. BLAND. Okay. So they had advertised and had in their contract a statement that they would never—and they used the word “never”—

Mr. PEARCE. I understand. I read your—so if you could sum it up, what is the settlement for?

Mr. BLAND. So the settlement was we got cash sent to people.

Mr. PEARCE. I mean why?

Mr. BLAND. Because they had been lied to, because they had been promised one thing—

Mr. PEARCE. So it is offering redress for damage?

Mr. BLAND. Yes.

Mr. PEARCE. Okay. How did you arrive at the figure of \$16 million?

Mr. BLAND. It was a hotly negotiated thing between the sides. I mean, I wish it had been more. I think it should have been more like \$25 million, but—

Mr. PEARCE. Could you have gotten more if you had went to trial?

Mr. BLAND. There is some possibility, and there is also some possibility we would have gotten nothing if we had gone to trial.

Mr. PEARCE. So—

Mr. BLAND. It was a hard-fought case.

Mr. PEARCE. You didn't have to confer with the class action folks. You were able to—the lawyers. I am not a lawyer, so I don't know. So the lawyers get to make a decision that you didn't have to refer it out to the people who had been damaged?

Mr. BLAND. We had a number of clients who we conferred with and told them what—where the settlements—

Mr. PEARCE. Okay. How many checks did you send out?

Mr. BLAND. In that case, we sent out over 100,000 checks.

Mr. PEARCE. The Wall Street Journal—I mean, the Washington Post, July 28, 2006, said out 200,000 checks. You said 100,000, more or less. Did you send out 100,000 requests for input?

Mr. BLAND. No, we didn't—well, we did. We sent out a notice to the class, and everyone in the class had an opportunity—

Mr. PEARCE. Input on the \$16 million?

Mr. BLAND. Yes. They had an opportunity to object or express any kind of concerns about it. And I fielded a whole bunch of phone calls from class members.

Mr. PEARCE. So the same article, July 28, says that you all took one quarter, approximately one quarter. I guess that the article was enough right that you didn't take issue with it in the comment section. So when I am doing the math, 16 million, so you take out a quarter; that is 4.025 million. Then it says another million goes to the law firm—goes to finding the people to distribute the money to them. Then the article says you gave out 200,000 checks; you are saying 100,000 checks. In the big scheme, the math doesn't change much. How much money did you not distribute, just roughly?

Mr. BLAND. I think you are right, that the attorney—so I think it was \$11 million that went out to the class and \$5 million end up being used—

Mr. PEARCE. About a million probably left over after the deal. So as I am doing the math—now, I am just trying to make this make sense to me.

So, recently, the American—excuse me—some airline, unnamed, lost a bag of mine. Sorry. It is on national TV. So I asked them: Can you give me 5 bucks where I can wash my clothes, because all of my clothes were in the luggage?

They said: No, we will do better. We will give you a voucher for 150 bucks, so you just go down there.

So I took the voucher for 150. Now, I assume that was some sort of a settlement to somebody who had problems before. But to me, it was very easy. It was extremely fair. Like Mr. Hong says, they wanted my business back, so they cured the problem up front.

So it might be when we only see 411 circumstances that many companies are doing it like that. They are intercepting the problems. They are saying: Look, we caused it.

I was willing to settle for \$5, a soap, and the dryer fee. They gave me \$150 to go buy new clothes. Now, I could have brought it to your firm and been a part of a class action, in which case you would have made \$4.025 million, and I would have gotten a check for 55 bucks. That is what you paid. That is what the average that went—that is the average that went to the claimants in your case.

Now, that is if there is 200,000. If there is actually 100,000, like you say, you can jack it up to 110.

So my—I am just sitting here trying to reason why the CFPB, looking out for consumers, would decide against a process that gives consumers basically \$5,000-plus for every solution in order to send it over to you, who is going to get an average—average of all the cases, 32 bucks, 32 versus 5,000, and we are claiming that to be consumer protection. And for the life of me, I think I will just settle for 150 bucks worth of free clothes, because it is easy and simple, and I don't have to be in court for 2 years.

Thank you, Mr. Chairman. I yield back.

Chairman NEUGEBAUER. I thank the gentleman.

And now the gentleman from Texas, Mr. Williams, a small-business man.

Mr. WILLIAMS. Thank you, Chairman Neugebauer.

And thank all of you for your testimony.

In full disclosure, I am a small-business man.

And, Mr. Bland, I am one of your favorite people. I am a car dealer for 44 years. And I can tell you: arbitration works a lot better than lawsuits.

I have a question for you, though, Mr. Bland. You are a trial attorney, correct?

Mr. BLAND. I represent consumers—

Mr. WILLIAMS. Trial attorney. And you have litigated as a lawyer in class action suits, correct?

Mr. BLAND. On many cases, yes.

Mr. WILLIAMS. So you consider yourself pretty much of an expert?

Mr. BLAND. Under the bar rules, you are not allowed to call yourself an expert in most States, but I have a lot of experience.

Mr. WILLIAMS. In your testimony, you note that the CFPB studied more than over 400 private class actions over a period of several years and found, in your words, that these class actions delivered very substantial benefits to more than 13 million Americans. Remember saying that?

Mr. BLAND. Yes.

Mr. WILLIAMS. Section 1028 of Dodd-Frank doesn't talk about class actions. It talks about producing a study on the use of arbitration agreements.

So, Mr. Bland, as a trial lawyer, I am sure you know the answer to this question before I ask it, but let me ask it to you. The sub-

stantial benefits that these Americans receive, the lawyers do pretty well too, don't they, like 30 percent?

Mr. BLAND. Actually, the CFPB studies show that 15 percent of the economic benefit in these cases went to the lawyers. So the 85 percent of the economic benefit went to the consumers in that study. And then a former Justice Scalia clerk, Professor Fitzpatrick, did a study, which found basically the same numbers.

Mr. WILLIAMS. I think the study put the number around 21 to 25 percent, or \$425 million of all cash recoveries. But in reality, I think that that number, and most of us believe, can be much higher, and you stated that with what you have talked about some of the things you have gotten.

So I guess section 1028 should not only read that eliminating these clauses has to be in the public interest and protection of the consumers but the trial lawyers as well.

So, Mr. Bland, how much settlement recovery would you need to expect to bring in in order to actually bring in a lawsuit for a consumer? In other words, when does a lawsuit to you become worth your while?

Mr. BLAND. I am in a nonprofit. I handle lots of cases for people who have a \$3,000 claim, but it is important interest. I do a ton of work on a pro bono basis. Probably 80 percent of the work that firm does has no expectation of receiving a fee whatsoever.

Mr. WILLIAMS. Some of those numbers you talked about earlier are not too pro bono.

Mr. BLAND. Well, I have been doing this work for 25 years.

Mr. WILLIAMS. Okay.

Mr. Pincus, would you mind providing your insight on this topic that we have talked about.

Mr. PINCUS. Well, a couple of points. I do think when you are looking at class actions, it is important to look at the costs and the benefits. And it is important not to assume, as some of the discussion has, that every class action that is filed is meritorious. If every class action that is filed were meritorious, we probably wouldn't have a problem. The problem is that we know from the studies that 87 percent of them didn't provide any benefit to the class. The 13 percent were settled, so we don't know if they were just settled for litigation value and maybe they, too, could have been fought if the company wanted to spend a lot of money on legal fees.

So we really don't know that the class action system is vindicating rights that have been wronged as opposed to just being a system that is very good for lawyers to bring cases and, to be frank, very good for the lawyers who defend them, but doesn't really do much for people except for transfer money around. And I think that is the major problem.

I think the other problem with class actions is someone was asking before about, you know, how would consumers know that they have been injured? Well, I think one of the problems in the class action system is often these are injuries that lawyers find that might be easy to litigate, but that real people may not care that much about. But once the litigation is started, if you can find one plaintiff, it obviously has a value. And I think that is another problem that we have.

Mr. WILLIAMS. Well, the bottom line, you said in your testimony: It is bad for business. It is bad for the consumer. And it is bad for mainstream America.

I am concerned that this rule, as proposed, could result in the loss of important products that actually help educate consumers, products such as credit monitoring, products that protect consumers from identity theft. I am concerned that these products that are beneficial to all of us would go away under the proposed arbitration rule. Do you agree with me?

Mr. PINCUS. I think it is a real problem, because there are some companies where the underlying statutes are so draconian in terms of the risk of liability that they can't risk the litigation because the costs will put them out of business, and there is a real problem about whether they can continue if they have to face that threat.

Mr. WILLIAMS. Okay.

I am down to my time. And I turn it back over to the chairman. Thank you.

Chairman NEUGEBAUER. I thank the gentleman.

Now the gentleman from Kentucky, Mr. Barr, is recognized for 5 minutes.

Mr. BARR. Thank you, Mr. Chairman.

Thanks to our witnesses for your testimony.

I want to just kind of ask a very kind of basic question about these arbitration clauses. None of these consumers are compelled in any way to enter into these contracts? Is that correct? I mean, if they want the service, they are free to enter into these contracts, or they are free to not take the product or services. Is that correct, Professor Johnston?

Mr. JOHNSTON. Correct.

Mr. BARR. So, Mr. Pincus? Mr. Hong? Mr. Bland?

Mr. HONG. Absolutely.

Mr. BARR. So maybe Mr. Bland would argue there are adhesion contracts, or there are no other choices out there in the marketplace. But the fact of the matter is that if arbitration was so heinous or despised as a dispute resolution method, presumably the marketplace would reject these contracts.

Is that a fair analysis, Mr. Pincus?

Mr. PINCUS. I think that is absolutely right, Congressman. And, you know, it is no different than every other—we are in a world of form contracts. Huge economies of scale. We get the benefit of those, but it is a take-it-or-leave-it basis. And just like I can't negotiate with my provider about the other terms, they say this one is take it or leave it too. If it were terrible, I would do it. And in all of the markets, there are providers that don't have arbitration.

Mr. BARR. I suspect Mr. Bland is going to disagree with you and me and my line of questioning, so I will give Mr. Bland an opportunity to chime in on that.

Mr. BLAND. I mean, just briefly I would say that there are some markets in which every single company in the market has the same arbitration clause that bans class action, so your choice is to just have no cell phone, for example. But also, it is not much consumer choice when the studies show that almost no consumers know about this.

Mr. BARR. Mr. Bland, what is the problem that we are trying to solve?

Mr. BLAND. The problem that we are trying to solve is that right now banks are putting into their fine print contracts provisions that say if they break the law, that consumers can't do anything about it.

Mr. BARR. Okay. So as a trial lawyer, as a class action plaintiff's attorney, you say we need to preserve or enhance access to the class action process. Doesn't that imply or suggest that the CFPB is either not doing its job in consumer protection or incapable of doing it?

Mr. BLAND. I think the CFPB does a great job. I don't think it is capable of doing the entire job. I think people should be able to have their own rights under the private rights of action that Congress passed for a bunch of these different statutes.

Mr. BARR. Okay. Well, if a private right of action is the solution, why should Congress empower the Bureau to have any regulatory power since you can solve it through the class action process?

Mr. BLAND. Well, I think what we have had in America, prior to the forced arbitration systems, you had a sort of a public-private partnership in which you have State attorney generals and the FTC handle certain types of cases, and then had private lawyers who represent people who don't want a government agency but want to be able to go forward on their own.

Mr. BARR. So this, I think, is the American people's frustration with Washington and the explosion of law.

Professor Johnston, I would love for you to chime in here on this point. It seems to me that if we have a problem, we are trying to solve it through both administrative law and through private right of action and through class actions. Wouldn't we prefer, wouldn't it be better consumer protection if we chose one course over the other as opposed to a layering of law?

Mr. JOHNSTON. I think the best course is to combine market incentives with a public enforcement mechanism.

And to get back to what you were mentioning earlier, remember, the CFPB found, true, 2 percent, very few people know about arbitration clauses or would ever talk to a lawyer if they found that a firm didn't refund a charge they thought had been unfairly assessed against them; 60 percent, almost, of the consumers said they would take their business elsewhere.

Arbitration supports that mechanism, the market mechanism.

Mr. BARR. Right.

Mr. JOHNSTON. A supplement to that is public enforcement.

Mr. BARR. And isn't it safe to assume that under the Bureau's proposed rule, the number of consumers injured without restitution will increase because of the cost associated with filing a lawsuit to address what may be a very small claim?

Mr. JOHNSTON. Oh, yes, they certainly can. You know, individual litigation in court, with or without an attorney, is very complicated and very costly compared to arbitration, orders of magnitude more costly, so it will preclude a lot of consumers from getting relief of any kind. And it will also interfere with the incentives of firms to invest in dispute resolution mechanisms.

Mr. BARR. Well, in my remaining time, if I could just say, I would agree that Dodd-Frank says that the Bureau should promulgate a rule if it is in the public interest and for the protection of consumers. I do not believe it is in the best interest of consumers to make it more difficult for arbitration which provides average relief of \$5,389, in contrast to class action suits where consumers recover an average of \$32.35 and, obviously, the attorneys take 20 percent of the award.

So I appreciate your testimony.

Yield back.

Chairman NEUGEBAUER. I thank the gentleman.

The gentleman from Colorado, Mr. Tipton, is recognized for 5 minutes.

Mr. TIPTON. Thank you, Mr. Chairman.

Panel, thank you for being here.

Professor Johnston, I am coming a little later on a number of the questions we have somewhat covered, and I just want to be able to have an actual understanding. And I will refer back a little bit to my colleague from New Mexico's line of questioning to Mr. Bland.

I think they were citing that the attorneys in that particular case got about \$4 million that went out. The consumers received \$55. Public justice. I think you have 16 attorneys on, so that came out to a quarter of a million dollars per attorney that went through. I know you have some other costs that you have to be able to pay for out of that.

But I am trying to get my arms really around the fairness issue literally for the consumers. I think you had cited that 85 percent of the award did go to the consumers that were out. And since, Professor Johnston, you have done some analysis on this, does 100 percent of those dollars actually reach the consumers' pockets?

Mr. JOHNSTON. I have to say in the category of cases that I have looked at that overlaps with what the CFPB did, the typical thing is that there is a very small amount of the actual nominal settlement goes to class members. And it is typical to find that attorney's fees dwarf the amount that the class as a group, not individually, but as a group gets.

For example, in the expiration date cases I mentioned earlier, on average—this is an unweighted average—attorney's fees are 895 percent of what the class gets, nine times what the class gets. Even in Telephone Consumer Protection Act cases where the amounts are much bigger, these are debt call settlements, so they would be covered by the CFPB's database, attorney's fees are 92 percent of what the class gets.

And I can compare the attorney's fees with individual class recoveries, and it is even more outrageous, because in a lot of these cases individuals are getting very small amounts of 30, 40, 50 dollars each. It is a system in which the cost of making these transfers is exorbitant. Essentially we are running this system just to transfer money from defendants to class counsel and kind of almost as an afterthought class members get a little bit.

Mr. TIPTON. I would like to drill down on that just a little more, I guess, to the point I want to be able to get. The 100,000 or 200,000, I think, in the exchange that we had had earlier where

money was actually allocated by the court to the consumers, real dollars, some of that is undeliverable. Somebody isn't going to cash the check. It is not going to be received.

Mr. JOHNSTON. True.

Mr. TIPTON. What happens to that money? Where does it go?

Mr. JOHNSTON. Oh, where it goes, it depends. In a minority of class settlements, that money does not revert back to the defendant. That is a small number. In every case in my sample, that will go as a cy-pres award to a nonprofit, every case, a nonprofit legal organization such as Mr. Bland.

Mr. TIPTON. So the money that is not collected actually by the consumer may well go back to Mr. Bland?

Mr. JOHNSTON. Yes, and that is in a minority, and in most cases the defendant just keeps it, it doesn't go anywhere.

Mr. TIPTON. It just doesn't go anywhere.

Mr. BLAND. Can I tell you what happened in that case, since you keep bringing it up?

Mr. TIPTON. Sure.

Mr. BLAND. So the money that was left over was largely give to Legal Aid of Maryland, which also represented a lot of the people who had the same kinds of issues. And we also, we fixed everybody's credit record. There was false information on all of these people's credit records that we eliminated. We had expert testimony before the court that that was worth many millions of dollars to the class members.

Mr. TIPTON. Okay. Great. Thanks for some clarity on that.

Mr. Johnston, I would like to go back to you a little bit, actually back to the CFPB in terms of their calculations, in terms of relief versus expenses in some of these class action lawsuits. How did they get their calculation off so far in terms of—I think the number you had cited, attorney fees, 21 percent, according to CFPB, you are putting that number at 75 percent. How is the CFPB so far off?

Mr. JOHNSTON. Well, that is a real number. They just aggregated up, added up all the attorney's fees paid and divided that by all the money that was paid to class members in all of their class action settlements that they studied.

The problem is those are swamped, those numbers of theirs are swamped by five huge class action settlements, the biggest of which is the checking account overdraft class action settlement, but then there is a few others.

In those giant settlements, courts will not approve attorney's fees that are much above 20 percent. I mean, if you have a \$250 million settlement, the court is not going to approve, I don't know, a \$125 million attorney's fee award.

But if you take those out and look at the run-of-the-mill class action settlement, courts approve attorney's fees, which when you compare it to the nominal settlement, they look reasonable, like 33 percent maybe, or 40 percent. But when you compare it to the amount the class actually gets, like I said, they are astronomical. Sometimes the fees are three, four, eight times what the class actually gets.

And the problem with that kind of system is, who would ever hire a lawyer—imagine if it was an individual lawsuit instead of a class lawsuit—who would hire a lawyer and say: Yes, I am going

to recover \$100, but I am going to pay you \$800. I am going to pay you \$800 to recover 100.

That is what we are doing. You take away the gigantic class action settlements where, again, judges are not going to approve \$125 million for a \$250 million settlement. But these other ones, this is what happens.

Chairman NEUGEBAUER. The time of the gentleman has expired.

Mr. TIPTON. Thank you.

Chairman NEUGEBAUER. I thank the gentleman.

Now the gentleman from Indiana, Mr. Stutzman, is recognized for 5 minutes.

Mr. STUTZMAN. Thank you, Mr. Chairman.

And thank you to the panel for being here. It has been an interesting discussion today.

And I am not an attorney. I am not a professor. I am a small-business owner. And so we may not find ourselves in these situations very often, but I can approach it from the standpoint of being sued as a small-business owner and what options do we have rather than going to court. Is there an arbitration process that we could enter into to try to solve an issue sooner rather than later?

And because I know, Mr. Bland, I know the folks in your industry, and I believe that the intentions are good. But in the long run it costs the economy, it costs consumers, it costs businesses more in the long run than it does if we can solve a problem, you know, face-to-face meeting, and what does it take to make both sides satisfied? Because, especially as a small-business owner and you are facing some sort of litigation, you want to handle the problem correctly, you want to handle the problem as quickly as possible, and you want to handle it to where you are being fair.

I mean, as I said, as a small-business owner, we found ourselves in that spot, and we wanted to make sure that those who were offended were made whole, and we did that. And it was cheaper to do it outside of a process in court rather than actually going through court and actually doing it through an arbitration process.

And so I guess that is what I am, you know, I am trying to wrap my mind around this in a class action situation. And I think we have all seen them. We get the envelope in the mail that says you are going to be eligible for some sort of 50-cent claim on some sort of class action lawsuit. And I throw them in the trash. I don't do anything with them. And I am not trying to say that that is every case, but in a lot of different cases.

And, Professor Johnston, I would like to ask you in regards to the Bureau's proposed rule, is there any evidence to suggest that it considered less severe regulatory alternatives to eliminating arbitration entirely? And I don't know if you touched on that earlier.

Mr. JOHNSTON. Congressman, we haven't talked about that, and that is an interesting, important question. Having just looked, once again, through the whole proposal very early this morning, I can say the answer is no. There is no evidence that they thought about any other regulatory approach than this, because they insist over and over again, with very little empirical evidence and no rigorous theoretical basis, that we have to have class actions to have deterrence in compensation. They didn't think about really any other alternative.

Mr. STUTZMAN. Would you suggest anything else?

Mr. JOHNSTON. Well, the evidence that the CFPB did uncover shows that arbitration works really well, but there aren't very many of them. We have heard that is the complaint today. There are only 411.

What about having the CFPB advertise the availability of arbitration? What about them help in informing consumers about their rights under these arbitration provisions? That seems to me like an agency that was trying to protect the interests of consumers and further the public interest, that would be at least something you would consider.

Mr. STUTZMAN. So maybe the process is working.

Mr. JOHNSTON. Yes.

Mr. STUTZMAN. Is there a perfect system? No. But this is about—I know for us, in my personal experiences, that this is a good process to have available to you.

Mr. Pincus—sorry, was somebody else going to say something? Okay. Mr. Pincus, some supporters of this proposed have argued that arbitration is just unfair, that it deprives consumers from their constitutional right. Has the Supreme Court, has any court weighed in on this issue at all?

Mr. PINCUS. The Supreme Court has made clear that arbitration doesn't deprive anyone of rights. It has repeatedly upheld and applied to Federal Arbitration Act. And so I think it has really addressed that issue.

Could I just respond to the question that you were asking to Professor Johnston, because I think it is important to note, because people have referred to the small number of arbitrations. In a way, that number is sort of an iceberg, because all arbitration systems say, before you start the arbitration, let's try and work this out, exactly what you said. And so a huge number of claims are resolved at that process and never go to arbitration, and the CFPB didn't try to even get any data on what that is.

I can give you one metric that is in the public record. I represented AT&T in a litigation that went to the Supreme Court, and one of the questions raised was: Gee, your arbitration system must be ineffective because people don't file many. And what AT&T said was, and this was a number of years ago: Well, we have calculated the number of credits and payments and other resolutions in this pre-arbitration process, and it came at that time to \$1.3 billion a year.

So that is, obviously, a very substantial amount of consumer relief that isn't captured in the number of arbitrations, but is a function of the availability of the arbitration system.

Chairman NEUGEBAUER. The time of the gentleman has expired.

I now recognize the gentleman from California, Mr. Royce, for 5 minutes.

Mr. ROYCE. Thank you, Mr. Chairman.

I thank our witnesses for joining us here.

The Credit Repair Organization Act, CROA, is a strict liability consumer protection statute that Congress passed to defend consumers against false claims of fixing credit reports.

Unfortunately, access to credit monitoring services provided by credit Bureaus and others has been threatened by the courts moving away from Congress' original intent with CROA.

So my first question to Mr. Pincus, what is the impact of eliminating class action lawsuit waivers for those under CROA's jurisdiction that offer credit score monitoring?

Mr. PINCUS. Well, unfortunately, it will open the door to these very large, very draconian class actions that can really impose—threaten hundreds of millions, maybe more in liability. And in the real world, again, we don't know whether it is meritorious or not, but the company can't take the chance. So it is either going to have to pay a lot of money in settlement, which is going to change its whole business structure, or it is going to conclude it can't be in that business anymore because the risk is just too great.

Mr. ROYCE. Or without a fix to the CFPB's rule or a fix to CROA, which I proposed with House Resolution 347, the Facilitating Access to Credit Act, my conclusion would be that credit monitoring products and services would be severely limited, but certainly one of those consequences.

Community financial institutions, if we go to another important subject here, such as credit unions and community banks, have to maintain strong personal relationships with their customers. At a time of unprecedented regulatory burdens, their success depends upon this.

So my second question, to Mr. Hong, how does the arbitration process benefit consumers and contribute to better relationships between consumers and their community financial institutions, and what will happen when the CFPB opens up credit unions and community banks to class action lawsuits?

Mr. HONG. If I can speak on behalf of those smaller institutions. One of the things that you will see that, one of benefits that arbitration can provide them is the fact that they have developed these dispute resolution processes that are more informal and convenient for consumers in nature. And so if you take away their ability to offer those types of proceedings, you potentially open them up for dramatic increases in class action litigation risk.

And so in those instances, they will probably have to have a conversation with at least potential regulators about how they should take compensatory actions on their side to reserve more capital to deal with that type of risk. And I am sure it just makes prudent business sense to hold on to more capital for defensive litigation purposes.

Mr. ROYCE. Well, I would like to ask unanimous consent to submit a letter to the record from the Credit Union National Association that highlights the problems the CFPB's arbitration rule will create for community financial institutions.

Chairman NEUGEBAUER. Without objection, it is so ordered.

Mr. ROYCE. And lastly, if I have the time, I would like to ask Mr. Bland briefly, if I could, I would like to get back to this cy-pres donation issue and ask—because the website lists you personally as the point of contact for these cy-pres donations—could you tell me how many cy-pres donations from class action lawsuit cases has Public Justice received in 2016, and what is the aggregate dollar value of those awards, if I could ask?

Mr. BLAND. I am not sure the exact number. I would have to look it up. Probably about half a dozen. And I think it is probably in the nature of \$700,000.

Mr. ROYCE. So I would ask for that data for 2016 and 2015, if you have that, and if you could provide this committee with a list of the source and amount of such donations Public Justice has received maybe in the last 5 years. That would be, I think, helpful to the committee. Thank you.

Mr. Chairman, thank you again. I think my time has expired.

Chairman NEUGEBAUER. I thank the gentleman.

With unanimous consent, I am going to yield to Mr. Scott for one additional question.

Mr. SCOTT. Yes. Thank you very much.

This question is very important to me because it reflects my deep concern for my constituents in Georgia. I don't know if this committee knows or not, but according to the FDIC, their latest data of 2013, 37 percent of the households in Georgia are either unbanked or underbanked.

And so, you see, I have a concern that—CFPB is a wonderful organization, I have no qualms with that, doing a fine job. But the purpose of this committee is to kind of examine what could be unintended consequences so we can work those out. And this 37 percent is magnified because the national average is just 10 percent.

So my State of Georgia is in the crosshairs here and depends upon nontraditional financial service products, like prepaid cards and general purpose reloadable prepaid cards. And so I got to be very concerned about that.

So my question is, how do we know that the prepaid cards, things like that that our people have to use and secure access to financial help that many of us just take for granted, how do we know that the CFPB is going to be able to work to make sure that these instruments are still available and affordable for the 37 percent of Georgia households in my State? And what steps are they taking to make sure that this happens, given a situation like this?

And granted, to your point, Mr. Bland, about the differentiation of the amount, suffice it to say, as professor Johnston pointed out, as we grapple with this, we have to find an answer to where this situation is and how the consumers will benefit the most with this outrageous gap of, say, from \$55, as this report says, to the \$5,400 that the report says is there.

So you got to understand, we have to come to grapple with this. But in my last 42 seconds here, would anybody have any idea if the CFPB is looking at maybe some of these unintended consequences?

Mr. PINCUS. Well, I think the concern is, based on their study and based on what is accompanying the rule, they really haven't looked at what the consequences are of the sort of layering on that was being discussed before of their supervisory and regulatory and enforcement role, plus other State and local agencies, plus private class actions, and whether there isn't a way to ensure that nothing falls between the cracks that is meritorious. We don't want that.

But to say, for example, one solution that comes to my mind is the CFPB gets notified of things that have a class-wide effect that people are worried about and it can look into them. You know, it

doesn't just have its enforcement authority. It has its supervisory authority, which gives it another very important tool for dealing with things that are adversely affecting consumers without going through the whole enforcement process.

So I think what is unfortunate is they have sort of, in a knee-jerk way, said we are just going to have the class action system layered on top of everything without looking at what that is really going to do to the cost of availability if things, just as you are mentioning.

Mr. SCOTT. Did you want to respond, Mr. Bland?

Mr. BLAND. Please, quickly.

Mr. HONG. Do you mind, if I can just add?

Mr. SCOTT. Oh, okay. Mr. Hong.

Mr. HONG. I was just going to add one additional comment, which was the fact that one of the reasons why we asked the CFPB to do a supplemental study to get a more comprehensive picture of how this rule might affect borrowers is that exposing financial institutions to more class action litigation risk exposure, that potentially locks away capital for productive uses. And I think that speaks directly to the issues that you are trying to raise.

Mr. BLAND. May I have 20 seconds on this? For 3½ years, 4 of the largest credit card companies in America stopped using their arbitration clauses that ban class actions as a result of an antitrust suit. And during those 3½ years they did not increase their interest rate, they did not increase any fees, there was no impact at all of them going naked without the arbitration clause that bans class action.

So all this stuff about how it is going to harm the economy and drive up prices and so forth, we had an actual experiment, and it is set out in the study, and we know the answer. And the answer was that not having the class action ban did not increase fees or costs.

Mr. JOHNSTON. Can I respond to that?

Chairman NEUGEBAUER. Mr. Johnston.

Mr. JOHNSTON. I mean, just on basic economics, there is no reason we would have expected to see any change in prices with what was at the time perceived to be a temporary change in cost, and, moreover, the statistical assumptions that have to be met for the experiment to be valid were not met.

Chairman NEUGEBAUER. I thank the gentleman.

I want to thank our witnesses, and I also want to thank our members. I think we have had a healthy discussion today, and I appreciate the witnesses offering their time here. And I yield briefly to the gentleman from Georgia for a unanimous consent.

Mr. SCOTT. Yes. I would just ask for unanimous consent to submit for the record this letter from the Public Citizen nonprofit organization.

Chairman NEUGEBAUER. Without objection, it is so ordered.

And also, I ask unanimous consent that we make a part of the record a statement from the National Association of Federal Credit Unions, a research paper by Jason Scott Johnston entitled, "High Cost, Little Compensation, No Harm to Deter: New Evidence on Class Actions Under Federal Consumer Protection Statutes."

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

Chairman NEUGEBAUER. And with that, this hearing is adjourned.

[Whereupon, at 4:50 p.m., the hearing was adjourned.]

A P P E N D I X

May 18, 2016

**“Examining the CFPB’s Proposed Rulemaking on Arbitration: Is it in
the Public Interest and for the Protection of Consumers?”**

**Subcommittee on Financial Institutions and Consumer Credit,
U.S. House of Representatives Committee on Financial Services**

Hearing, May 18, 2016

Testimony of F. Paul Bland, Jr.

Executive Director of Public Justice¹

¹ Public Justice pursues high impact lawsuits to combat social and economic injustice, protect the Earth’s sustainability, and challenge predatory corporate conduct and government abuses. I oversee Public Justice’s docket of consumer, environmental and civil rights cases. I have argued or co-argued and won more than 30 reported decisions from federal and state courts across the nation, including cases in six of the federal Circuit Courts of Appeal and at least one victory in nine different state high courts. I was named the “Vern Countryman” Award winner in 2006 by the National Consumer Law Center, which “honors the accomplishments of an exceptional consumer attorney who, through the practice of consumer law, has contributed significantly to the well being of vulnerable consumers.” In 2013, I received the Maryland Consumer Rights Coalition’s “Legal Champion” award. In 2010, I received the Maryland Legal Aid Bureau’s “Champion of Justice” Award. In the late 1980s, I was Chief Nominations Counsel to the U.S. Senate Judiciary Committee. I graduated from Harvard Law School in 1986, and Georgetown University in 1983. For more than 15 years, Public Justice has operated a special project devoted to fighting abuses of mandatory arbitration. We have represented consumers in a large number of cases challenging abuses of forced arbitration clauses, in state and federal courts, for more 15 years. While arbitration clauses are widely enforceable as a matter of federal law, we have successfully represented consumers in cases where corporations added outrageous terms to their arbitration clauses (such as requiring consumers with small claims to travel across the country), or corporations have attempted to enforce arbitration clauses against consumers who never agreed to them, and similar abuses.

INTRODUCTION

The Consumer Financial Protection Bureau's Proposed Rulemaking on Arbitration is unquestionably in the public interest and will serve to protect consumers. Specifically, it will protect consumers from the use of forced arbitration clauses that ban them from filing or participating in class actions, a widespread practice that large banks, payday lenders and various sorts of predatory lenders have used to exempt themselves from most private enforcement of America's consumer protection laws.

Exempting the financial industry from the normal legal system has had far-reaching – and disastrous – consequences. Predatory lending and dishonest lending practices have pushed millions of people right into desperation. Far too many Americans have been tricked into taking out loans that were far more expensive than they realized.

In recent years, for example, if a bank systematically cheated 10,000 customers in the same way, the bank could use its arbitration clause to stop those customers from going to court together. Each individual had to figure out the scam, figure out what their rights were and then spend time and money fighting the bank. In the incredibly inefficient system that banks foisted on their own customers, everyone was essentially on their own. In contrast, a class action could offer all 10,000 people a fair shot at justice.

The CFPB conducted an extensive empirical study of forced arbitration. Its results, reported to Congress in March of 2015, are entirely consistent with what most experts in consumer law would have predicted:

- The vast majority of credit card issuers, payday loan lenders, and other financial institutions require their consumers to submit any disputes that they might have – even if the bank has plainly broken the law – to a private arbitrator. The arbitrator is generally picked by a company that itself is picked by the bank. The arbitration system is largely secretive, and there is no meaningful judicial review of an arbitrator's decision (even if she makes a glaring error of law or engages in “silly” fact-finding). These arbitration clauses overwhelmingly ban consumers from bringing or participating in class actions.
- Very few consumers understand the fine print disclosures about the forced arbitration clauses, which are written in dense legalese and slipped by consumers in ways that few if any of them would read.
- Incredibly few consumers ever actually take cases to arbitration, and very few of them recover much. The CFPB looked at *every single arbitration* conducted by the American Arbitration Association (by far the largest private arbitration company in the United States that handles consumer cases) over a period of three years in cases against lenders. In those three years, the TOTAL number of cases that consumers arbitrated against lenders was 411 per year. Out of hundreds of millions of arbitration clauses, and compared to the legal system, where more than 13 million consumers received recoveries in class actions. That is not a typo. *Throughout, the entire United States*, the total number of arbitrations against lenders each year was 411. Sec. 1, p. 11.

- Over those three years, and again for the entire United States, 32 (thirty two) consumers won recoveries from arbitrators in cases against lenders, where the arbitrators issued decisions. Sec. 1, p. 11. In those 32 cases, the consumers recovered 12 cents for every dollar of their legal claims. Sec. 5, p. 13.
- By contrast, in a study of 400 private lawsuits that were brought in court and litigated as class actions, more than 13 million customers received more than \$2.7 billion in recoveries. Sec. 1, p. 16. The attorneys' fees in those class actions amount to 16% of the gross relief received by the consumers. Sec. 8, pp. 23, 32-33.
- Banks that use forced arbitration clauses that banned class actions did NOT reduce the interest and fees they charged consumers. An empirical comparison of four of the largest credit card issuers in the United States (Bank of America, Chase, Capitol One and HSBC) that did not have forced arbitration clauses with class action bans for 3 ½ years (they stopped using them for this time period as part of a settlement of an antitrust case) with other banks that *did* have forced arbitration clauses shows that the lenders that used forced arbitration clauses with class action bans did not reduce their interest or fees at all. The claim that "consumers will benefit from lower costs if corporations can exempt themselves from the consumer protection laws with fine print contracts" is simply empirically false. It hasn't happened, and it never did happen.

I. FEW CONSUMERS UNDERSTAND THE FORCED ARBITRATION CLAUSES IN THE FINE PRINT OF THEIR CONTRACTS

The supporters of forced arbitration and class action bans like to talk about this as a “voluntary choice” that consumers make. There is no polite way to say the truth here: these claims are a joke. Almost no consumers meaningfully “choose” to enter into arbitration clauses. These fine print legalese documents are slipped by consumers in ways that ensure they will never notice them.

The CFPB study concluded, based upon extensive empirical survey data, that “consumers are generally unaware of whether their credit card contracts include arbitration clauses. Consumers with such clauses in their agreements generally do not know whether they can sue in court or wrongly believe that they can do so.” Sec. 1, p. 11.

Moreover, when one compares what consumers think about their arbitration clauses with what the clauses actually say, it turns out that most consumers misunderstand them. “Consumer beliefs about credit card dispute resolution rights bear little to no relation to the dispute resolution provisions of their credit card contracts. Most consumers whose agreements contain arbitration clauses wrongly believe that they can participate in class actions.” *Id.* For example, “Less than 7% of consumers whose credit card agreements included pre-dispute arbitration clauses stated that they could not sue their credit card issuers in court.” Sec. 3.1, p. 4. In one extensive empirical survey quoted by the CFPB at length, researchers at St. John’s law school found that even when consumers were pointed to the arbitration clause and asked to

read it, only “approximately 13% understood that the contract they had just been shown prohibited them from participating in a class action lawsuit.”

The conclusions in the CFPB’s study are hardly surprising. Most people first learn that a company says they have lost the right to sue – and have “waived” their constitutional right to trial by jury and a day in court – only after a dispute arises. In most cases, an individual’s first awareness of an arbitration clause comes as a bitter surprise. We have spoken to literally hundreds of persons on this topic over the past few years, including homeowners, farm operators, consumer and civil rights attorneys, consumers, employees, journalists and arbitrators. Again and again in those conversations, we have heard from people – often very angry and very dissatisfied people – who were utterly unaware that they had been sent an arbitration clause, and who believed that they had never agreed to such a clause.

A wealth of scholarship supports the conclusions of the CFPB St. Johns studies. Another recent study conducted by Credit.com found that 66% of credit cardholders did not know what, if any, changes had been made to their credit card agreements. Eileen A.J. Connelly, *Credit Card Holders Frequently Don't Pay Attention to Changes Made to Accounts, Survey Finds*, Star Trib. (Minneapolis), March 1, 2009. In at least one case, evidence showed that a bank knew only four percent of cardholders would read its bill stuffers. See Sen. Russell D. Feingold, *Mandatory Arbitration: What Process Is Due?*, 39 Harv. J. on Legis. 281, 296 (2002) (citing case); see also Shmuel I. Becher, *Asymmetric Information in Consumer Contracts: The Challenge That Is Yet to Be Met*, 45 Am. Bus. L.J. 723, 730-31 (2008) (“empirical evidence shows that most consumers do not read [standard form contracts]”); Amy J. Schmitz, *Consideration of “Contracting*

Culture” in *Enforcing Arbitration Provisions*, 81 St. John’s L. Rev. 123, 160 (2007) (“consumers rarely read or understand” arbitration agreements); Debra Pogrud Stark & Jessica M. Choplin, *A License to Deceive: Enforcing Contractual Myths Despite Consumer Psychological Realities*, NYU J. Law & Business (2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1340166 (discussing studies showing that consumers are unlikely to read standard-form contracts).

II. INCREDIBLY FEW CONSUMERS EVER GO TO ARBITRATION

The CFPB’s study,² as shown above, demonstrates that only a tiny number of consumers ever go forward with claims against lenders in arbitration. The numbers are almost unbelievably small – slightly over 400 cases of any sort brought anywhere in the U.S. each year against lenders and, over a three year period, only 32 consumers actually winning awards in arbitration.

² After roughly a year of collecting data and comments, the Bureau released a preliminary report in late 2013. It then spent another year and a half gathering more data, analyzing primary documents from hundreds of court cases and arbitration records, soliciting further comments, and conducting extensive interviews with consumers and industry representatives before publishing its final report in March 2015. The final report provides an extensive and exhaustive analysis of the prevalence of arbitration clauses in consumer financial contracts, their effects on consumer protection, and the relative merits of arbitration and court litigation as means of protecting consumers’ interests. The final report ran nearly 800 pages long, and has been rightly called the most comprehensive study of this issue to date. The industry claims that the agency needs to engage in further study are like those from people who say that we need more evidence to tell us cigarette smoking is bad for children. The industry claims that it didn’t have enough input into the study are almost bizarre – bank CEOs, CFOs and bank lobbyists, lawyers and advocates have held literally hundreds of meetings with the CFPB over a period of nearly four years where they have had every opportunity (and have regularly exercised that opportunity) to voice their views about why forced arbitration is supposedly good for consumers.

This is consistent with Public Justice's experience: Very few consumers have any interest in bringing cases in arbitration. There are a number of factors that we see again and again:

- The arbitration system is foreign and confusing to consumers. Most consumers don't know what the word means, or wrongly assume they can still go to court.
- The rules of the arbitration providers are lengthy, hard to find, and often it's not clear which set of rules apply. The American Arbitration Association has many different sets of rules, and cases are often litigated for some time as to which set of rules will govern in a given case.)
- Consumers often must pay up front expenses that exceed what they'd have to pay in a court. It is not at all uncommon for corporations to refuse to pay their share of arbitrators' fees (even when their customer contracts promise that they will pay most of the costs of arbitration), so when consumers do go to arbitration there are often extensive delays while the arbitration company collects fees from the company.
- There are a number of examples of arbitrators requiring consumers to pay enormous "loser pays" awards (meaning that even if a consumer brought a well-grounded case and they end up losing before the private corporate arbitrator, they are forced to pay the corporation's attorneys' fees, in some cases amounting to several hundred thousand dollars), which makes consumers reluctant to go to arbitration.

- Most private consumer lawyers are very reluctant, or completely unwilling, to represent clients in a system that they believe is rigged against consumers. Unlike the banking industry lawyers, consumer lawyers generally only get paid if they win cases. Many of them have a reasonable, earned distrust of forced arbitration, and extensive surveys of consumer lawyers consistently show that most will walk away from a case rather than go to arbitration.

The CFPB study's findings that very, very few consumers go to arbitration are not even slightly surprising to experienced consumer lawyers. Let me start with an example. I represented a client who was cheated by a bank in a case, but because the U.S. Supreme Court changed the law governing forced arbitration clauses fairly dramatically while the case was pending, our client ended up receiving nothing and none of the other consumers who were cheated in the same way received anything. In *Homa v. American Express*, our client, Mr. Homa, agreed to purchase a credit card based on the company's offer of a specific set of conditions and terms. In fact, however, he discovered that the terms that were advertised were far better than what a cardholder could ever receive and that the credit card company was misleading people about the true cost of its loans (by exaggerating the size of the rebates the cardholders were supposed to receive).

Mr. Homa, who is far better at numbers than the average consumer, figured out the scam – that his rebate was much lower than he had been promised -- and tried to get his money back. The company rebuffed him at every turn, telling him he had miscalculated the rates and that he was not entitled to his money. He finally went to a lawyer, who told him that, while he had a valid claim, the damages in his case were so

small that it did not make financial sense to pursue his claim on an individual basis. After realizing that the company had likely cheated many consumers in this bait and switch scheme, Mr. Homa sought to hold the company liable for its unfair and deceptive lending practice by filing a class action complaint in federal court.

Because the amount of individual damages was so small and the nature of the claims was so complex, no one could actually obtain a remedy on an individual basis. The company nevertheless sought to force Mr. Homa into arbitration on an individual basis, but this effort was rejected by the U.S. Court of Appeals for the Third Circuit, which found that the American Express arbitration clause's ban on class actions was "unconscionable." In other words, because the ban on class actions would gut the state of New Jersey's consumer protection laws, and give the bank a 'get of jail free' card, the court struck down the arbitration clause as unenforceable.

Then the U.S. Supreme Court intervened, with its notorious decision in *Concepcion v. AT&T Mobility*, 131 S. Ct. 1740 (2011).³ In this 5-4 decision, Justice Scalia invented a new rule of federal law that wiped away state contract laws that refused to enforce contracts that undermined consumer protection or civil rights laws. After *Concepcion*, the district court was provided with a powerful evidentiary record that proved no consumer could effectively vindicate his or her statutory rights relating to the claims at issue in the case under American Express's arbitration clause, including expert testimony, testimony from Mr. Homa, and records of the paltry number of

³ Justice Ginsburg recently gave a speech where she compared the Court's decision in *Concepcion* with the infamous *Lochner*-era decisions from the U.S. Supreme Court back in the early part of the 20th Century, when the Court would strike down laws such as minimum wage and child labor laws as an infringement of freedom of contract.

arbitrations pursued. This evidence, as well as the plaintiff's briefs, is available at our website, www.publicjustice.net, on the page dedicated to the *Homa* case. American Express did not bother to challenge the evidentiary record, taking the position that these facts did not matter, after *Concepcion*. Notwithstanding this evidence, the district court dismissed the case and enforced the arbitration clause without comment.

On a final appeal to the Third Circuit, the Court of Appeals accepted the factual record showing that American Express's ban on class actions would gut Mr. Homa's case: "We accept this characterization, for the record demonstrates that the significant cost of arbitrating Homa's claim and the likelihood that there would be a limited recovery even if his arbitration was successful makes it unlikely that an attorney would take his case. Furthermore, in view of the complexity of the issues pertaining to the merits of Homa's claim, it would be very difficult for him to prosecute the case without the aid of an attorney whether in a judicial proceeding or in arbitration."

Notwithstanding these facts, in light of the *Concepcion* case, the Third Circuit said that American Express's arbitration clause should be enforced even though the arbitration offered only an "illusory remedy": "Even if Homa cannot effectively prosecute his claim in an individual arbitration **that procedure is his only remedy, illusory or not**. Though some persons might regard our result as unfair, [the Federal Arbitration Act] requires that we reach it." 494 Fed. Appx. 191 (2012).

Similarly, I was co-counsel in a class action that was litigated in Maryland state court, *Wells v. Chevy Chase Bank*. The credit card issuer had promised in promotional materials and in its contract that it would "never" raise its interest rates above 24%, and

then it did raise its interest rates (as well as add a number of other charges) for a number of people. It was a classic bait-and-switch. The case was settled for \$16.1 million (as well as actions taken to remove improper negative information from class members' credit records), and checks were mailed to more than 200,000 class members. (Compare this, again, to the 411 people who take cases to arbitration each year against lenders throughout the entire United States.)

During the challenge to the arbitration clause in the *Wells* case, however, evidence was put before the trial court that if the arbitration clause had been enforced, no consumers would have been able to pursue their claims on an individual basis. This evidence was never challenged or refuted by the defendant, who argued that this did not matter. Our clients had approached a number of lawyers without finding any willing to handle the case, and the case was only filed shortly before the limitations period ended. This was an important case that needed to be brought, and which resolved very favorably for the consumers, but if the arbitration clause had been enforced, no consumers would have received any recovery.

As one further example, I was co-counsel in five cases brought against payday lenders in North Carolina state court. While payday lending is legal in many states, it was not in North Carolina. The judge divided the five cases into two groups, to better manage them. The first three cases were litigated and resolved before the *Concepcion* decision. We settled those cases for \$45 million, and sent checks to more than 200,000 class members. The second two cases were thrown out because of the payday lenders' class action bans, and so far as I know, not a single one of the consumers pursued their claims in arbitration and recovered anything. The contrast is striking:

200,000 consumers who retained their constitutional rights to go to court recovered \$45 million and received checks, and tens of thousands of consumers who were subject to forced arbitration clauses with class action bans received nothing.

III. CLASS ACTIONS HAVE BROUGHT ENORMOUS BENEFITS TO CONSUMERS.

As set forth above, the CFPB studied more than 400 private class actions over a period of several years. It found that these class actions delivered very substantial benefits to more than 13 million Americans. Consumers received direct payments for cash (refunds of overcharges, for example); credits to their accounts; the elimination of illegal or inflated debts; and the removal of false information from their credit records. Despite the widespread use of forced arbitration clauses, the consumers who WERE able to go forward in court were able to receive substantial recoveries.

The Bureau also compared, side-by-side, banks that were all engaged in the same illegal practice – manipulating the order in which checks were paid out, so as to dramatically increase the number of hefty late fees that were levied on consumers. Banks which either did not have arbitration clauses with class action bans or which were not able to enforce them in court for various reasons were forced to (a) compensate their customers for the illegal practice and refund hundreds of millions of dollars; and (b) change their illegal practice. Banks who did have arbitration clauses that banned class actions did not pay out anything (unless some of the 32 Americans who recovered monies in forced arbitration over three years might have gotten back money for this particular practice), and continued the illegal practice.

My own experience is consistent with the Bureau's conclusions. As set forth in the previous section, I have personally been counsel in a number of cases (I gave four examples, but I could have given many more) where hundreds of thousands of consumers recovered substantial sums, and had incorrect information removed from their credit records.

It is also important to note that the Bureau's conclusion that attorneys' fees were modest compared to the magnitude of the consumers' recovery has been supported by substantial academic scholarship. Consider this study by a law professor who had been a clerk for Justice Scalia: Fitzpatrick, Brian T., An Empirical Study of Class Action Settlements and Their Fee Awards (July 7, 2010). *Journal of Empirical Legal Studies*, Vol. 7, 2010; CELS 2009 4th Annual Conference on Empirical Legal Studies Paper; Vanderbilt Public Law Research Paper No. 10-10; Vanderbilt Law and Economics Research Paper No. 10-06. Available at SSRN: <http://ssrn.com/abstract=1442108> or <http://dx.doi.org/10.2139/ssrn.1442108> ("Although there have been prior empirical studies of federal class action settlements, these studies have either been confined to securities cases or have been based on samples of cases that were not intended to be representative of the whole (such as those settlements approved in published opinions). By contrast, in this article, I attempt to study every federal class action settlement from the years 2006 and 2007. As far as I am aware, this study is the first attempt to collect a complete set of federal class action settlements for any given year. I find that district court judges approved 688 class action settlements over this two-year period, involving nearly \$33 billion. Of this \$33 billion, roughly \$5 billion was awarded to class action lawyers, or about 15 percent of the total.")

IV. IT IS IMPORTANT TO REMEMBER A KEY POINT OF HISTORY: THE COMPANY THAT WAS THE LARGEST PRIVATE ARBITRATION PROVIDER IN THE U.S. FOR ABOUT 10 YEARS WAS SHUT DOWN FOR CORRUPT AND ILLEGAL BEHAVIOR

The Committee should look back at history of the late (but not lamented) National Arbitration Forum (NAF). This testimony will cite to a wealth of information that demonstrates the following propositions: (a) for about a decade, NAF was by far the largest provider of arbitration services to lenders for consumer arbitration; (b) NAF's operations were outrageously unfair to consumers, and favorable to lenders, to a degree where words such as "corrupt" are entirely fair characterizations; (c) the overwhelming majority of courts took no action with respect to the NAF, as courts were reluctant or unwilling to probe into the fairness of a major arbitrator who was used by many corporations, in the wake of the Supreme Court's rush to favor mandatory arbitration; and (d) the exact same factors that gave rise to the NAF – corporate desire for immunity from consumer protection law; a desire to win all or nearly all of the cases that were brought by consumers; a willingness by some actors to do ANYTHING to favor corporations if this would bring them substantial income; and the unwillingness of courts to meaningfully police arbitration – could easily give rise to a very similar actor down the road.

Simply put, there is no reason whatsoever that such an entity could not arise again, cloak itself in respectability (as the NAF did by spending a ton of money on articles and studies praising itself, hiring former judges and prominent political figures, energetically litigating to block any discovery into its operations and to get secrecy orders covering any documents that did become public, etc.), and operate in a similarly unfair situation for an indefinite period. Indeed, if the Minnesota Attorney General had

not happened to discover that the NAF had crossed the most blatant line of inappropriate conduct – taking tens of millions of dollars for shares of a wholly owned corporation from entities who were currently litigating tens of thousands of cases in front of NAF – the NAF might well still be cheating consumers and operating as a semi-secret arm of the bank-defense community. Various lovers of mandatory arbitration like to say things along the lines of “the NAF is gone, the entities left are all much better, no one should think about that period any more; nothing to see here, move on.” I suggest that the reality is more complex than that, and pose the question: “How can mandatory arbitration by lenders be fair when by far the largest provider of arbitration services for a decade operated in a dishonest and lawless manner, nothing happened, and there is nothing to stop this from happening again?”

Before it was shut down by a law enforcement action brought by the Minnesota Attorney General, however, very few courts ever struck down NAF arbitration clauses on the basis of bias, and the organization operated on a large scale for about a decade after the first evidence emerged that its neutrality was questionable. It took the discovery that NAF had a substantial undisclosed conflict of interest before it was shut down. On July 14, 2009, the Attorney General of Minnesota sued the NAF and its corporate affiliates for consumer fraud, deceptive trade practices, and false advertising based on the NAF’s undisclosed financial relationship with one of the country’s largest debt collection law firms. See Compl. at ¶ 5, *State v. Nat’l Arbitration Forum, Inc.* (Minn. Dist. Ct. July 14, 2009). Within days, the NAF announced that it would cease conducting consumer arbitrations. See Robin Sidel and Amol Sharma, *Credit-Card Disputes Tossed Into Disarray*, Wall Street Journal (July 21, 2009).

Although the NAF did not initially acknowledge any wrongdoing after the Minnesota action was filed, a year and a half later the company *did* admit that the key allegations in the Minnesota complaint were true:

On April 6, 2011 the NAF executed a settlement agreement in which it formally stipulated that effective June 27, 2007 it became a holding company, transferred its operations to two subsidiaries and sold a 40% ownership interest in one of the subsidiaries to participants in the consumer debt collection industry for \$42 million.

Torrence v. Nationwide Budget Finance, No. 05-0047, 2012 WL 335947 at ¶ 30 (N.C. Super. Ct. Jan. 25, 2012).

NAF aggressively marketed itself to credit card companies and debt collectors.⁴ While it NAF trumpeted itself to the public as fair and neutral, “[b]ehind closed doors, NAF sells itself to lenders as an effective tool for collecting debts.”⁵ In its solicitations

⁴ See Caroline E. Mayer, *Win Some, Lose Rarely? Arbitration Forum's Rulings Called One-Sided*, Wash. Post, Mar. 1, 2000, at E1 (“[A]rbitration industry experts say [that] the forum’s business involves more corporate-consumer disputes, in large part because of the company’s aggressive marketing.”).

⁵ Robert Berner & Brian Grow, *Banks v. Consumers (Guess Who Wins)*, BusinessWeek, June 5, 2008. See also Sean Reilly, *Supreme Court Looks at Arbitration in Alabama Case This Week*, Mobile Reg., Oct. 1, 2000, at A1 (“In marketing letters to potential business clients, [NAF’s] executives have touted arbitration as a way of eliminating class action lawsuits, where thousands of small claims may be combined.”); Sarah Ovaska, *3 Cases Cite Payday Lending: Consumer Groups Say Arbitration Clauses Deny People Recourse to Courts*, News & Observer, Jan. 7, 2007 (“[NAF], which in 2006 resolved \$3 billion worth of claims involving debts and other disputes, has been singled out by consumer advocates, who criticize it for advertising its services to businesses.”).

and advertising, NAF “has overtly suggested to lenders that NAF arbitration will provide them with a favorable result.”⁶ BusinessWeek described a September, 2007, PowerPoint presentation aimed at creditors—and labeled “confidential”—that promises “marked increase in recovery rates over existing collection methods.”⁷ The presentation also “boasts that creditors may request procedural maneuvers that can tilt arbitration in their favor. ‘Stays and dismissals of action requests available without fee when requested by Claimant—allows claimant to control process and timeline.’” Speaking on condition of anonymity, an NAF arbitrator told BusinessWeek that these tactics allow creditors to file actions even if they are not prepared, in that “[i]f there is no response [from the debtor], you’re golden. If you get a problematic [debtor], then you can request a stay or dismissal.”⁸ BusinessWeek also highlighted another disturbing NAF marketing tactic: NAF “tries to drum up business with the aid of law firms that represent creditors.” Neither AAA nor JAMS cooperate with debt-collection law firms in such a manner.⁹

NAF had an arsenal of other ways of letting potential clients know that NAF can immunize them against liability. One NAF advertisement depicted NAF as “the alternative to the million-dollar lawsuit.”¹⁰ Additionally, NAF sent marketing letters to potential clients in which it “tout[s] arbitration as a way of eliminating class action

⁶ Ken Ward, Jr., *State Court Urged to Toss One-Sided Loan Arbitration*, Charleston Gazette & Daily Mail, Apr. 4, 2002, at 5A.

⁷ Robert Berner & Brian Grow, *Banks v. Consumers (Guess Who Wins)*, BusinessWeek, June 5, 2008.

⁸ *Id.*

⁹ *Id.*

¹⁰ Nadia Oehlsen, *Mandatory Arbitration on Trial*, Credit Card Mgmt., Jan. 1, 2006, at 38

lawsuits, where thousands of small claims may be combined”¹¹ NAF’s marketing letters also urged potential clients to contact NAF to see “how arbitration will make a positive impact on the bottom line” and told corporate lawyers that “[t]here is no reason for your clients to be exposed to the costs and risks of the jury system.”¹²

The NAF also manipulated who was selected to be arbitrators, so that favored clients got better results. The Center for Responsible Lending analyzed this data and reached two conclusions: (a) companies that arbitrate more cases before certain arbitrators consistently got better results from those arbitrators, and (b) individual arbitrators who favored creditors over consumers got more cases in the future.¹³ Similarly, the Christian Science Monitor analyzed one year of data and found that NAF’s ten most frequently used arbitrators—who were assigned by NAF to decide nearly three out of every five cases—ruled for the consumer only 1.6% of the time. In contrast, arbitrators who decided three or fewer cases during that year found in favor of the consumer 38% of the time.¹⁴ Likewise, Public Citizen’s analysis found that one particular arbitrator, Joseph Nardulli, handled 1,332 arbitrations and ruled for the corporate claimant 97% of the time. On a single day—January 12, 2007—Nardulli

¹¹ Sean Reilly, Supreme Court Looks at Arbitration in Alabama Case This Week, *Mobile Reg.*, Oct. 1, 2000, at A1.

¹² See Caroline E. Mayer, Win Some, Lose Rarely? Arbitration Forum’s Rulings Called One-Sided, *Wash. Post*, Mar. 1, 2000, at E1.

¹³ Joshua M. Frank, Center for Responsible Lending, *Stacked Deck: A Statistical Analysis of Forced Arbitration* (2009), http://www.responsiblelending.org/credit-cards/research-analysis/stacked_deck.pdf.

¹⁴ Simone Baribeau, *Consumer Advocates Slam Credit-Card Arbitration*, *Christian Sci. Monitor*, July 16, 2007.

signed 68 arbitration decisions, giving debt holders and debt buyers every cent of the nearly \$1 million that they demanded.¹⁵ If Nardulli worked a ten-hour day on January 12, 2007, he would have averaged one decision every 8.8 minutes. Busy arbitrators like Nardulli are well-compensated for workdays like this one—as one former NAF arbitrator noted, “I could sit on my back porch and do six or seven of these cases a week and make \$150 a pop without raising a sweat, and that would be a very substantial supplement to my income. . . . I’d give the [credit-card companies] everything they wanted and more just to keep the business coming.”¹⁶

NAF also blackballed arbitrators who dared to rule in favor of consumers. Harvard law professor Elizabeth Bartholet went public with her concerns that, after she awarded a consumer \$48,000 in damages, NAF removed her from 11 other cases, all of which involved the same credit card company, on the credit card company’s objection. As Bartholet described her experience to *BusinessWeek*, “NAF ran a process that systematically serviced the interests of credit card companies.”¹⁷ Bartholet told the *Minneapolis Star-Tribune* that “[t]here’s something fundamentally wrong when one side has all the information to knock off the person who has ever ruled against it, and the little guy on the other side doesn’t have that information. . . . That’s systemic bias.”¹⁸

¹⁵ Public Citizen, *The Arbitration Trap: How Credit Card Companies Ensnare Consumers* 17 (2007), <http://www.citizen.org/documents/ArbitrationTrap.pdf>.

¹⁶ Chris Serres, Arbitrary Concern: Is the National Arbitration Forum a Fair and Impartial Arbiter of Dispute Resolutions? *Star Trib.* (Minneapolis), May 11, 2008, at 1D.

¹⁷ Robert Berner & Brian Grow, *Banks v. Consumers (Guess Who Wins)*, *BusinessWeek*, June 5, 2008.

¹⁸ Chris Serres, Arbitrary Concern: Is the National Arbitration Forum a Fair and Impartial Arbiter of Dispute Resolutions? *Star Trib.* (Minneapolis), May 11, 2008, at 1D.

Another deeply troubling element of Bartholet's experience comes from how NAF explained Bartholet's removal from her cases to the parties in those cases. NAF sent letters to the parties stating that "due to a scheduling conflict, the Arbitrator previously appointed is not available to arbitrate the above case." When Bartholet asked the NAF case administrator about the letters, the administrator "agreed that [Bartholet] was likely being removed simply because of [her] one ruling against the credit card company." NAF's legal counsel did not deny this explanation.¹⁹

Similarly, former West Virginia Supreme Court Justice Richard Neely stopped receiving NAF assignments after he published an article accusing the firm of favoring creditors. In that article, Justice Neely lamented that NAF "looks like a collection agency" that depends on "banks and other professional litigants" for its revenue; he described NAF as a "system set up to squeeze small sums of money out of desperately poor people."²⁰

As one final note, in testimony that I submitted to the Subcommittee on Domestic Policy of the House Committee on Oversight and Government Reform in July 22, 2009, I set forth extensive evidence of how the NAF regularly entered awards against people who had been the victims of identity theft, who had been sued on debts that were far past the statute of limitations, and other abuses.

¹⁹ Courting Big Business: The Supreme Court's Recent Decisions on Corporate Misconduct and Laws Regulating Corporations, 110th Cong. (2008) (statement of Elizabeth Bartholet), available at http://judiciary.senate.gov/hearings/testimony.cfm?id=3485&wit_id=7313.

²⁰ Robert Berner & Brian Grow, *Banks v. Consumers (Guess Who Wins)*, BusinessWeek, June 5, 2008.

The supporters of forced arbitration have never yet offered a convincing explanation for why the Congress, the CFPB or policymakers should just ignore the fact that for nearly a decade, the company that handled more consumer arbitrations than any other provider operated in a flagrantly biased, pro-bank manner.

CONCLUSION

The CFPB is living up to its name. The Bureau really IS protecting consumers. The banking industry's attacks on the CFPB's proposed rule should be seen for what they are: an effort to let the banks and payday lenders just exempt themselves from laws that they don't feel like following.

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Has presented at more than 100 continuing legal education or professional conferences in more than 25 states; has testified in both houses of Congress, several state legislatures and administrative agencies; has been quoted in more than 100 periodicals throughout the country and has appeared in several radio and TV stories.

Has argued and won appeals where courts rejected claims that various federal laws preempted pro-consumer state laws: *Aguayo v. U.S. Bank*, 653 F.3d 912 (9th Cir. 2011) (National Bank Act did not preempt state debt collection law); *Epps v. J.P. Morgan Chase Bank*, 675 F.3d 315 (4th Cir. 2012) (same); *Singh v. Prudential Health Care Plan, Inc.*, 335 F.3d 278 (4th Cir. 2003) (claims under Maryland HMO Act survived ERISA's preemption); *McKee v. AT&T Corp.*, 191 P.3d 845 (Wash. 2008) (Federal Communication Act does not preempt state contract law); *Sweeney v. Savings First Mortgage*, 897 A.2d 1037 (Md. 2005) (federal law does not preempt state statute limiting mortgage brokers' fees); *Wells v. Chevy Chase Bank*, 832 A.2d 812 (Md. 2003) (Home Owners Lending Act does not preempt state contract law claims against credit card issuer).

Has argued and won several appeals where courts limited abuses of mandatory arbitration clauses: *Lee v. Intelius, Inc.*, 705 F.3d 1129 (9th Cir. 2013) (arbitration clause not enforceable where "even an exceptionally careful consumer would not have understood" that they were agreeing to arbitration by clicking on icon on website); *Gibson v. Nye Frontier Ford, Inc.*, 205 P.3d 1091 (Ak. 2009) (selective appeal provision unconscionable; employer must pay all substantial costs of arbitration); *Cordova v. World Fin. Corp.*, 208 P.3d 901 (N.M. April 29, 2009) (one-sided arbitration provision unconscionable); *Toppings v. Meritech Mortgage*, 569 S.E.2d 149 (W.Va. 2002) (where a lender's arbitration clause designates an arbitration forum that is paid through a case volume fee system, and the arbitration forum's income is dependent on continued referrals from the creditor, this so impinges on neutrality and fairness that the clause is unconscionable); *Raymond James Fin. Servs., Inc. v. Saldukas*, 896 So.2d 707 (Fl. 2005) (broker waived right to compel arbitration, even though investor proved no prejudice); *Lewallen v. Green Tree Servicing, LLC*, 487 F.3d 1085 (8th Cir. 2007) (also finding waiver of right to compel arbitration by a lender).

Other successful oral arguments include: *Rhodes v. R+L Carriers, Inc.*, 491 Fed. Appx. 579 (6th Cir. 2012) (employment discrimination claim pled with sufficient specificity to meet *Iqbal* standards); *United States v. United States ex rel Thornton*, 207 F.3d 769 (5th Cir. 2000) (relators under *qui tam* provisions of the False Claims Act are entitled to receive a statutory share of the value of some non-cash proceeds of a settlement between the U.S. and the defendants); *Dua v. Comcast/Harvey v. Kaiser*, 805 A.2d 1061 (Md. 2002) (statute that retroactively stripped consumers of accrued cause of action violated provisions of state constitution).

Formerly Chief Nominations Counsel, U.S. Senate Judiciary Committee, 1989-1990
EDUCATION: **Harvard Law School** – J.D. 1986; **Georgetown University** – A.B. 1983



**Written Statement of
Dong Hong
Vice President, Regulatory Counsel
Consumer Bankers Association**

Before the

**House of Representatives
Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit**

For the Hearing

**“Examining the CFPB’s Proposed Rulemaking on Arbitration: Is it in the Public
Interest and for the Protection of Consumers?”**

May 18, 2016

Chairman Neugebauer, Ranking Member Clay, and members of the Subcommittee, thank you for the opportunity to discuss to the Consumer Financial Protection Bureau's ("CFPB" or "Bureau") activities related to arbitration agreements for consumer financial products and services. My name is Dong Hong and I am Vice President and Regulatory Counsel at the Consumer Bankers Association ("CBA").¹

CBA preserves and promotes the retail banking industry as it strives to fulfill the financial needs of the American consumer and small business. As the voice of the retail banking industry, CBA represents nearly 70 members whose products and services provide access to credit for consumers and small businesses. Our members operate in all 50 states, serve more than 150 million Americans and collectively hold two-thirds of the country's total depository assets.

A fundamental principal of banking is to establish strong relationships with customers and the communities in which they serve. CBA members value their customer relationships and are committed to delivering superior customer service and quality financial products. As service providers, our members heavily rely on customer feedback to resolve issues and understand how best to meet the their financial needs. This customer-centric focus is why our members devote substantial resources responding to customer complaints with the goal of ensuring each customer is satisfied with the resolution.

¹ Founded in 1919, the Consumer Bankers Association is the trade association for today's leaders in retail banking -- banking services geared toward consumers and small businesses. The nation's largest financial institutions, as well as many regional banks, are CBA corporate members, collectively holding two-thirds of the industry's total assets. CBA's mission is to preserve and promote the retail banking industry as it strives to fulfill the financial needs of the American consumer and small business.

Dispute Resolution and the Benefits of Arbitration

Overwhelmingly, disputes between CBA member companies and their customers are resolved through informal channels and do not elevate to formal proceedings. Our members have strong business incentives to maintain deep, well-informed, mutually satisfactory relationships with their customers. Disputes rise to the level of a formal action in court or arbitration only a fraction of the time. In fact, it is often in a company's best interest to avoid litigation or arbitration due to the costs of the proceedings. When a dispute does elevate to this level, arbitration is an efficient alternative to litigation.

In short, arbitration is a procedure wherein two parties involved in a dispute select an unbiased third person(s) or "arbitrator(s)" to hear both sides and issue a decision. Today, arbitration provisions can be found in a wide variety of consumer agreements, including those for credit cards, checking accounts, cell phones, cable television, internet access, and even gym memberships.

Since the Federal Arbitration Act was passed in 1925, federal law has protected—and the Supreme Court has confirmed—the benefits of arbitration as a faster and higher recovery alternative to class action litigation for consumers. In fact, a resolution through arbitration can take just 2-7 months, depending on the format. Consumer fees for arbitration are limited by the American Arbitration Association ("AAA"), and companies often end up footing the total bill. Due in part to consumers

paying little to nothing for arbitration proceedings, they recover significantly higher sums than they do through class actions (\$5,389 vs. \$32.35 average recovery).²

In contrast, litigation can be complicated, time-consuming and requires a lawyer to navigate the process. In addition, many consumer claims may be too small to attract contingency fee lawyers. As Supreme Court Justice Stephen Breyer has said, without arbitration, “the typical consumer who has only a small damage claim (who seeks, say, the value of only a defective refrigerator or television set) [would be left] without any remedy but a court remedy, the costs and delays of which could eat up the value of an eventual small recovery.”³

Despite the Supreme Court’s support of arbitration and the clear consumer benefits this form of dispute resolution offers, the CFPB recently issued a notice of proposed rulemaking on arbitration (“Proposal”) which would, among other things, subject covered companies to a higher risk of class action lawsuits and reduce the ability of consumers to take their disputes through arbitration.⁴ CBA does not believe the Bureau’s Proposal comports with the requirements set out by Congress in Section 1028 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”). As such, CBA appreciates the Subcommittee’s interest in whether the Proposal serves the best interest of consumers and would encourage efforts to require the Bureau to conduct a more complete analysis of arbitration before finalizing a Proposal which would restrict its use.

² Bureau of Consumer Financial Protection, Arbitration Study: Report to Congress 2015, (Mar. 10, 2015) at <http://www.consumerfinance.gov/data-research/research-reports/arbitration-study-report-to-congress-2015/>.

³ *Allied-Bruce Terminix Cos. V. Dobson*, 513 U.S. 265, 281 (1995).

⁴ Bureau of Consumer Financial Protection, Arbitration Agreements, Proposed Rule with Request for Public Comment, Docket No. CFPB-2016-0020 (May 5, 2016), at http://files.consumerfinance.gov/f/documents/CFPB_Arbitration_Agreements_Notice_of_Proposed_Rulemaking.pdf.

Dodd-Frank Mandated Study Did Not Support Proposal's Conclusions

Section 1028 of the Dodd-Frank Act directs the CFPB to conduct a study of arbitration relating to consumer financial products and services and present a report to Congress on its findings. Importantly, it also authorizes the Bureau to restrict or even prohibit the use of mandatory pre-dispute arbitration agreements for such products or services if, *and only if*, it is “in the public interest and for the protection of consumers” and consistent with the results of the study. Based on the statutory language it is clear that Congress wanted to ensure that any regulation would be based on a fair, complete study of the real-world implications of restricting the use of arbitration.

In 2013, the CFPB began the study process by failing to accept sufficient input from the public. In fact, on March 22, 2013, the Chairmen and Subcommittee Chairmen of the House Financial Services and Judiciary Committees wrote to the Bureau with suggestions and inquiries regarding the arbitration study, but their requests were ignored. Likewise, CBA offered its comments to the Bureau prior to the start of the study and again on its proposed telephone survey of consumer awareness of arbitration provisions in credit card agreements⁵, which was later incorporated into the study. Unfortunately, several items raised in our letters were left unaddressed.

On March 15, 2015, the CFPB released its study, which was presented as being highly critical of arbitration and unabashed in its preference for class actions lawsuits. However, once the public had

⁵ Letter from Steve Zeisel, Executive Vice President, Consumer Bankers Association *et al* to Richard Cordray, Director, Bureau of Consumer Financial Protection (Aug. 6, 2013) at <http://consumerbankers.com/cba-issues/comment-letters/joint-trade-letter-arbitration-survey>.

an opportunity to read the report, it became clear the research does not support such an aggressive interpretation of the data on the part of the Bureau.

Examination of the CFPB's Study

A review of the CFPB's study conducted by experts at the Mercatus Center at George Mason University found that it "fail[s] to support any conclusion that arbitration clauses in consumer credit contracts reduce consumer welfare or that encouraging more class action litigation would be beneficial to consumers and the economy."⁶

Industry assessments of the Bureau's study concur with these conclusions. While the Bureau's study is the most extensive one ever conducted on arbitration, it remains incomplete and fails to prove that restricting arbitration is "in the public interest and for the protection of consumers." For instance, the study did not consider the context in which formal dispute resolution processes are situated. The vast majority of consumer disputes are handled and resolved through internal company processes, such as a simple conversation with a bank's customer service representative.

In addition, the study makes a false comparison when it compares class action settlements with arbitration awards. This methodology decision results in a bias towards class action lawsuits as arbitration settlements are not counted in favor of consumers. Succinctly stated, arbitration is more

⁶ Jason Scott Johnston & Todd Zywicki, *The Consumer Financial Protection Bureau's Arbitration Study: A Summary and Critique*, Mercatus Center, George Mason University (Aug. 2015), at <http://mercatus.org/publication/consumer-financial-protection-bureau-arbitration-study-summary-critique>.

likely to result in settlement when one party has a higher probability of success than the other, and both parties view settlement to be a more efficient outcome than seeking a final decision on the merits. The CFPB's study indicates that about half of all arbitrations resulted in a settlement, but it provides no data on the terms of the ultimate resolution. Disregarding settlements and focusing on only the 32.2 percent of arbitration decisions resolved on the merits potentially excludes data that would support even higher recoveries for consumers. At a minimum, the exclusion of settlements biases the arbitration results towards the most difficult or contested cases. Recalling the purpose of the study was to examine arbitration alone this is a significant oversight, especially in light of the data collected to support the Bureau's conclusions on class actions.

As previously mentioned, the study made use of a telephone survey on consumer awareness of dispute resolution provisions in their credit card agreements. Unfortunately, the survey featured lengthy and complex questions which could in no way produce information that is meaningful in determining whether regulation of the use of pre-dispute arbitration would be "in the public interest and for the protection of consumers." In addition, the survey's random selection of consumers lacked the sufficient information to assess and compare the merits of arbitration and litigation. In fact, few consumers possess knowledge about the benefits, disadvantages, and costs of arbitration and the various forms of judicial litigation as a part of dispute resolution processes (e.g., small claim litigation, individual, non-small claims litigation, and class action litigation) unless they have had experience with them. Thus, the vast majority of responses to the Bureau's telephone survey lacked an adequate foundation, and thereby yielded unreliable data.

In addition, the CFPB's study does not consider the full impact of public supervision and enforcement on consumer welfare and protection. While the study does examine public enforcement activity, it limits such consideration to the years between 2008 and 2012. This seems to be an awkward and odd choice since the CFPB, the agency established to supervise the consumer financial markets, has only been operational since July 21, 2011. Director Cordray has recently been on record stating the Bureau has recovered \$11.2 billion for consumers through enforcement actions, and another \$300 million through supervisory action. These figures do not even include the actions taken by other federal and state agencies, such as the Department of Justice and State Attorneys General. If the study had been more inclusive of such supervision and enforcement actions, it would have painted a very different picture of how consumers – outside of the regular and informal resolution processes at a financial institution – can obtain restitution when companies are found to be in violation.

Notwithstanding the preliminary nature of the study, it could be fairly interpreted as demonstrating consumers are better served taking their disputes through arbitration than participating in a class action lawsuit. The Bureau's own study shows 60 percent of class actions produced no benefits for putative class members. Only 15 percent of class actions received final class settlement approval and no class action was actually tried on the merits. In class settlements that required putative class members to submit a claim form, 96 percent of the putative class received nothing since they did not file a claim. And consumers who did obtain cash payments received only \$32.35 on average, a trivial amount given the cases took about two years to settle. In comparison, consumers who went through arbitration averaged \$5,389 in cash payments in a third of the time.

The conclusions drawn in the study in support of class actions also fail to acknowledge that not every dispute can be incorporated in to a class action. Many disputes have unique facts and circumstances which would require independent litigation. For instance, consider the ATM that failed to appropriately credit the consumer's deposit. In this case and many others, the dispute is of an individual nature which cannot be resolved through a class action. Eliminating the availability of arbitration would leave these consumers with individual litigation as their only option.

At the very least, the CFPB's study shows the Bureau does not have a complete understanding about consumer experiences with arbitration. The Bureau concedes as much when it acknowledges in its study that it was unable to gather any significant data on arbitration settlements, which is a critical element of any fair evaluation of arbitration. This absence of data from consumers who have either benefited from arbitration settlements or found the process unsatisfactory highlights the CFPB's lack of understanding of the true impact on consumers.

In summary, the arbitration study provides an insufficient basis for restricting the use of arbitration, especially in light of the higher recoveries (\$5,389 on average) received by consumers through this form of dispute resolution. Eighty-six Members of Congress reached similar conclusions and rebuked the study as lacking in fairness and transparency; they have asked the CFPB to reopen the study and allow for public comment.⁷ The House Appropriations Committee has also unanimously agreed a new study is necessary. CBA appreciates Congress's attention to the study and encourages further engagement with the CFPB to develop additional analysis of arbitration.

⁷ Letter from Tim Scott, U.S. Senator, Patrick McHenry, U.S. Congressman, *et al* to Richard Cordray, Director, Bureau of Consumer Financial Protection, (Jun, 17, 2015), at <http://mchenry.house.gov/uploadedfiles/mchenry-scott-to-cordray-letter-re-arbitration.pdf>.

CBA Recommendations

The study, which would have benefited from peer review and public comment, lacked some critical elements necessary for a thorough analysis to ultimately determine whether restricting arbitration is “in the public interest and for the protection of consumers.” In a letter to Director Cordray (see attached letter in Appendix A), CBA and other trade associations asked the Bureau to conduct additional research to complete its study before making any final policy decisions on arbitration.

CBA reiterates our request and offer the following suggestions on how the CFPB should re-examine and supplement its study:

- Conduct a comparison between litigation and arbitration on the basis of accessibility, cost, fairness, and efficiency;
- Ascertain if consumers would benefit from becoming more informed about arbitration;
- Survey consumers who have experience with litigation, class actions, and arbitration about their level of satisfaction with these dispute resolution processes;
- Examine the net benefit of class actions to consumers in light of the supervisory or enforcement authorities of State and Federal regulatory and enforcement agencies;

- Determine if prohibiting or restricting the availability of mandatory pre-dispute arbitration provisions would effectively eliminate arbitration as an alternative dispute resolution process for the majority of consumers; and
- Inspect whether prohibiting or restricting the availability of mandatory pre-dispute arbitration provisions would impact the cost and availability of credit to consumers and small businesses.

Conclusion

Strong and effective consumer protection and fair and responsible banking are profoundly important to our member banks. CBA routinely engages with the CFPB and other regulators to promote reasonable and effective regulation that ensures consumers have the ability to choose safe and affordable products and services. It is our concern the CFPB's Proposal will result in increased costs of financial services and products and inhibit the ability of financial institutions to innovate and better serve their customers. In short, consumers stand to lose from the CFPB's proposal purportedly meant to provide greater relief.

CBA stands ready to work with Congress and the CFPB to develop a regulatory framework that promotes affordable and innovative financial products and services. In addition, CBA is open to working together to address potential shortcomings in our members' dispute resolution processes to ensure customers have access to speedy and cost-effective recourse when disputes arise. On behalf of our members, I appreciate the opportunity to testify before the Subcommittee.

APPENDIX A

Via Federal Express

July 13, 2015

The Honorable Richard Cordray
Bureau of Consumer Financial Protection
1275 First Street, NE
Washington, DC 20002

Re: Comments on the Bureau's Consumer Arbitration Study

Dear Director Cordray:

The American Bankers Association,⁸ the Consumer Bankers Association,⁹ and The Financial Services Roundtable¹⁰ (collectively, the Associations) appreciate the opportunity to provide comments regarding the Bureau of Consumer Financial Protection's (Bureau) March 10, 2015, Study on Consumer Arbitration (Study).¹¹ In accordance with Section 1028 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), the Bureau, having completed its Study of

⁸ The American Bankers Association is the voice of the nation's \$15 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard \$11 trillion in deposits, and extend more than \$8 trillion in loans.

⁹ Founded in 1919, the Consumer Bankers Association (CBA) is the trade association for today's leaders in retail banking – banking services geared toward consumers and small businesses. The nation's largest financial institutions, as well as many regional banks, are CBA corporate members, collectively holding well over half of the industry's total assets. CBA's mission is to preserve and promote the retail banking industry as it strives to fulfill the financial needs of the American consumer and small business.

¹⁰ As advocates for a strong financial future™, the Financial Services Roundtable (FSR) represents 100 integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. FSR member companies provide fuel for America's economic engine, accounting directly for \$98.4 trillion in managed assets, \$1.1 trillion in revenue, and 2.4 million jobs.

¹¹ This is the Associations' third submission to the Bureau in connection with its study of consumer arbitration. On June 22, 2012, the Associations submitted comments in response to the Bureau's Request for Information Regarding Scope, Methods, and Data Sources for Conducting Study of Pre-Dispute Arbitration Agreements. And, on August 6, 2013, the Associations submitted comments in response to the Bureau's request for comments on its proposed telephone survey of consumers.

the use of arbitration provisions in consumer financial services contracts, is now considering whether a regulation prohibiting or limiting such provisions would be “in the public interest and for the protection of consumers.” Under Section 1028, any such regulation must be “consistent with the [S]tudy.”

Many of the Associations’ members, constituent organizations, and affiliates (collectively, Members) utilize arbitration agreements in their consumer contracts, and many of those contracts were included in the Study’s data set. The Associations’ Members are major stakeholders in the Bureau’s examination of consumer arbitration and will be affected negatively by any regulation of consumer arbitration adopted by the Bureau. Although the Bureau has not formally requested comment on the Study, we believe that, considering its potential impact on consumers and the business of banking as well as the misleading conclusions that have been drawn and reported about the Study, it is critical that the Bureau consider another perspective. Accordingly, we submit this analysis of the Study, which analysis we believe supports a conclusion that pre-dispute arbitration clauses benefit customers and that those benefits should not be restricted or prohibited.

I. SUMMARY

The Study clearly illustrates that arbitration has significant, demonstrable benefits over litigation in general and class action litigation in particular. It is faster, less expensive, and more effective than class action litigation. Customers who prevail in an individual arbitration recover monetary benefits that, on average, are approximately 166 times greater than the sums received by the average class member in a class action settlement.

Simply put, there are insufficient data in the Study to support a conclusion that mandatory pre-dispute customer arbitration provisions in financial services contracts, or the inclusion of class action waivers therein, should be prohibited; in fact, there are abundant data in the Study that contradict such a conclusion. Because such regulation would not be “consistent with the Study,” in the public interest, or necessary for the protection of consumers, it would exceed the Bureau’s authority under Section 1028 of the Dodd-Frank Act.

Moreover, if the Bureau were to over-regulate arbitration agreements or prohibit the use of class action waivers in such agreements, as some parties advocate, many companies are likely to discontinue offering arbitration to consumers. That outcome would harm consumers, as they would be deprived of a valuable and time-tested procedure for economically, expeditiously, conveniently, and efficiently resolving individual consumer disputes. Instead, consumers would be relegated to a procedure (class action litigation) in which they are likely to receive either no benefits at all or minuscule benefits that are awarded years after the initiation of the lawsuit. New regulatory limitations on arbitration agreements are likely also to result in increased costs to consumers for financial products and services. Rather than regulating consumer arbitration in financial services contracts, the Associations believe the Bureau should concentrate its efforts on educating consumers about arbitration, including how to make best use of arbitration terms that a contract may contain and the differences between arbitration and litigation, particularly class action litigation, so that consumers gain a better understanding of the many benefits that arbitration offers.

In addition, we identify numerous additional issues the Bureau should research and analyze before any meaningful final conclusions regarding the efficacy of customer arbitration provisions can be reached. These include customer satisfaction with arbitration and whether the creation of the Bureau and its own regulatory, enforcement, and supervisory activities are supplanting what

consumer activists contend are the main justification for class actions—*i.e.*, providing redress to large numbers of consumers and regulating corporate behavior.

Finally, we urge the Bureau to solicit public comment on the Study so that all interested stakeholders will have an opportunity to express their views on the important issues at hand before the Bureau decides whether to initiate a rulemaking proceeding. It would be premature for the Bureau to promulgate any regulation at this time considering the relatively brief time period that customer arbitration provisions have been used by companies.

A. Pro-Arbitration Findings

The data reported in the Study clearly demonstrate that arbitration is more beneficial to consumers than class action or individual litigation in a number of important ways. As discussed in detail in Section II.A. of this letter—

1. Arbitration is faster, less expensive, and more effective than litigation, including class action litigation, and customers are far more likely to obtain a decision on the merits and more meaningful relief.
2. The Bureau's statistics are consistent with the conclusion of the U.S. Chamber of Commerce in its December 2013 statistical analysis of class actions that the vast majority of class actions "produce no benefits to most members of the putative class" but "can (and do) enrich [their] attorneys." With respect to the 562 class actions examined by the Bureau in the Study—
 - At least **60%** of the class actions studied produced **no benefits** at all for the putative class members, because they were settled individually or withdrawn by the plaintiff.
 - Only **15%** of the class actions received final class settlement approval.
 - **No** class action was actually tried on the merits.
 - Consumers who received cash payments in class action settlements obtained an average of only **\$32.35**.
 - In class settlements that required putative class members to submit a claim form, the weighted average claims rate was only **4%**, meaning that **96% of the putative class members failed to obtain any benefits** because they did not submit claims.
 - Notwithstanding the foregoing statistics, attorneys' fees awarded to class counsel in settlements totaled **\$424,495,451**.

By contrast, **customers who prevailed in arbitration recovered an average of \$5,389, compared to the \$32.35 obtained by the average class member in class action settlements.** Thus, the average customer who prevailed in arbitration received **166 times more** in financial payments than the average class member in class action settlements.

3. The Study dispels the misconception that arbitration is a barrier to class actions. **Arbitration was not even a factor—and therefore presented no barrier—in 92% of the 562 class actions studied by the Bureau**, because so few defendants moved to compel arbitration and only about half of those few motions were granted. Moreover, there is abundant competition in the financial services marketplace to accommodate customers who prefer to resolve disputes via litigation as opposed to arbitration. The data show that 85% of credit card issuers and 92.3% of banks do not include arbitration provisions in their customer contracts. At least 25% of customers whose credit card and deposit account contracts contain arbitration provisions have a contractual right to reject the arbitration provision within 30 to 60 days of entering the contract without affecting any other provision in their contracts.
4. The Study also dispels the misconception that companies have an unfair advantage over customers in arbitration. The Study found that almost all of the arbitration proceedings involved companies with repeat experience in the forum. However, that was counter-balanced by the fact that counsel for the consumers were also usually repeat players in arbitration.¹² Moreover, in 81% of the arbitrations in which customers were awarded affirmative relief, the company was a “repeat player,” but the customer prevailed anyway.¹³
5. Many of the other statistics recited in the Study also reflect favorably on arbitration when placed in the proper context. For example—
 - The Study’s finding that customers initiated only 1,847 arbitration proceedings from 2010 through 2012¹⁴ does not reflect customer dissatisfaction with arbitration nor suggest that it is an ineffective remedy. In context, this statistic is reasonable given the multitude of other factors that materially affect the number of arbitrations filed by customers. Those factors include, *inter alia*, that (a) the vast majority of customers resolve their disputes with businesses informally without the need for arbitration or litigation,¹⁵ (b) customer arbitration is still in its infancy compared to civil litigation, (c) plaintiffs’ lawyers and consumer advocacy groups (many funded by plaintiffs’ lawyers) have sent consistently negative messages about arbitration to customers for many years to dissuade them from using it; (d) government enforcement and supervisory actions have eliminated much of the need for customers to bring private arbitration actions; and (e) individuals are turning increasingly to on-line arbitration and mediation resources to resolve small dollar customer complaints, which the Bureau chose not to include in the Study.¹⁶

¹² Study, § 1, p. 12; § 5, p. 10 & n. 16.

¹³ *Id.* § 5, p. 67.

¹⁴ *Id.* § 5, p. 9.

¹⁵ The Bureau itself has provided a portal through which financial services companies informally resolved more than 558,000 alleged customer complaints in the past three years. Each alleged complaint resolved obviated the need for the customer to commence an arbitration proceeding.

¹⁶ For example, in comments submitted to the Bureau when it initially proposed the Study, Modria, one of the leading companies offering online arbitration and dispute resolution services, stated that it handles more than 60

- The Study's finding that 75% of consumers surveyed telephonically did not know whether their contracts contain an arbitration provision underscores the need for the Bureau to concentrate its efforts on educating customers about the differences between arbitration and litigation (including class actions) and the many benefits that arbitration can offer customers for resolving their disputes with companies.

B. Analysis of the Study Underscores the Need for Additional Research to Inform Future Policy Decisions Regarding Arbitration

Before the Bureau decides whether or not to issue a regulation, it should research a number of important issues that either were omitted from or were not fully or properly analyzed in the Study. We believe that these issues, discussed in Section II. B below, are essential to a fair and balanced understanding of whether any regulation of consumer arbitration "is in the public interest and for the protection of consumers." They include—

1. Customer satisfaction with the arbitration process;
2. The cash awards, if any, that *individual* class members receive in class action settlements;
3. The economic consequences to customers and companies of regulation that would prohibit the use of arbitration provisions or class action waivers;
4. The impact of any regulation regarding customer arbitration on the provision of national and international online dispute resolution services (*see note 9 supra*);
5. Whether recent United States Supreme Court decisions, which make it more difficult to obtain class certification, weigh in favor of supporting arbitration as a method for customers to resolve their disputes with companies;
6. The impact of the Bureau's enforcement and supervisory actions from January 1, 2013, to date;

million disputes a year. *See* <http://www.regulations.gov/#!documentDetail;D=CFPB-2012-0017-0019>. Even if only a fraction of the disputes handled by Modria involve consumer financial services companies, it is obvious that the universe of customer disputes being addressed outside the courtroom is much larger and diverse than just the AAA database examined in the Study. Modria is only one of many online dispute resolution services. In their own initial comments on the Study, the Associations asked the Bureau to study the extent to which customers resolve their disputes with businesses through online dispute resolution in order to place more traditional customer arbitration services (such as the AAA) in the proper context. *See* <http://www.regulations.gov/#!documentDetail;D=CFPB-2012-0017-0030>. However, the Bureau did not do so. Before enacting any regulation affecting customer arbitration, the Bureau should study whether and how such a regulation would impact this ever-burgeoning national and international market for resolving customer disputes online.

7. Whether the class actions analyzed in the Study or the complaints in the Bureau's Consumer Complaint Database can be qualitatively evaluated to determine how many involved systemic issues that would have been amenable to class action treatment and certification; and
8. Customer experience with analogous areas in which the use of arbitration has a lengthier and more developed history, such as employment arbitration.

II. DISCUSSION

Section 1028 of the Dodd-Frank Act requires the Bureau to “conduct a study of, and to provide a report to Congress concerning, the use of agreements providing for arbitration of any future dispute between covered persons and consumers in connection with the offering or providing of consumer financial products or services.” Section 1028 further provides that the Bureau, “by regulation, may prohibit or impose conditions and limitations for the use of [such] an agreement” if it “finds that such a prohibition or imposition of conditions and limitations is in the public interest and for the protection of consumers.” The findings in such a regulation must be “consistent with the study.”

Notably, the Study—consistent with prior empirical studies of consumer arbitration conducted by the Bureau's own consultant¹⁷—includes a significant quantity of data demonstrating that arbitration is more beneficial to consumers than class action or even individual litigation and dispels key misconceptions about arbitration. These data weigh heavily against any regulation that would prohibit the use of arbitration provisions in consumer financial services contracts altogether, or materially condition or limit their use (for example, by banning the use of class action waivers). We discuss these data in Section A below.

A. The Study Clearly Demonstrates that Arbitration Benefits Customers

1. *Arbitration Is Faster for Customers than Litigation*

The Study demonstrates that customer arbitration is up to twelve times faster than customer litigation. The data show that (i) the median desk arbitration¹⁸ was resolved in 4 months; (ii) the

¹⁷ See, e.g., Christopher R. Drahozal, et al., “An Empirical Study of AAA Consumer Arbitration,” 25 Ohio St. J. on Disp. Resol. 843 (2010). This article discusses the results of the March 2009 study of AAA consumer arbitrations undertaken by the Searle Civil Justice Institute, Northwestern University School of Law. The study was based on a review of 301 AAA consumer arbitrations (240 brought by consumers, 61 brought by businesses) that were closed by award between April and December 2007. It reached the following conclusions: (a) the upfront cost of arbitration for consumer claimants was quite low; (b) AAA consumer arbitration is expeditious (an average of 6.9 months); (c) consumers won some relief in 53.3% of the cases filed and recovered an average of \$19,255 (52.1% of the amount claimed); (d) no statistically significant repeat-player effect was identified; and (e) arbitrators awarded attorneys' fees to prevailing consumers in 63.1% of cases in which the consumer sought such an award and the average attorneys' fee award was \$14,574.

¹⁸ **Desk arbitration** involves dispute resolution based on paper submission rather than a hearing.

median telephone arbitration was resolved in 5 months; (iii) the median in-person hearing was resolved in 7 months; and (iv) when the arbitration settled, the median arbitration proceeding lasted 2-5 months.¹⁹ By contrast, the average class action settlement received final court approval in 1.89 years, and federal court multi-district litigation (MDL) class actions filed in 2010 closed in a median of 2.07 years.²⁰

2. *Arbitration Is Less Expensive for Customers than Litigation*

The Study shows that customers pay far less to arbitrate than to sue in court. Prior to September 14, 2014, the customer's portion of the administrative and arbitrator fees charged by the American Arbitration Association (AAA) under its rules was capped at \$125. The company paid all of the remaining fees. Under the AAA's revised rules, the customer's share of those fees is capped at \$200, with the company paying the remainder.²¹ That is only one-half of the \$400 it costs to file a new complaint in federal court.²²

3. *Customers Recover More in Arbitration than in Litigation*

According to the Study, in arbitrations where customers obtained relief on affirmative claims and the Bureau could determine the amount of the award, the customer's average recovery was \$5,389 (an average of 57 cents for every dollar claimed).²³ By contrast, based on 73 of 74 individual federal court claims in which a judgment was entered for the customer, the average amount awarded to the customer was \$5,245.²⁴ At the other end of the spectrum are class members in consumer class action settlements. The Study states that cash payments to "at least 34 million consumers" during the period studied were "at least \$1.1 billion." This means that the average class member's recovery was a mere \$32.35.²⁵

The Study further concluded that in 60% of the 562 putative class actions studied, the putative class members got nothing at all, because 25% of the class actions were settled individually, while 35% were withdrawn by plaintiffs.²⁶ These statistics create a strong inference that many class actions

¹⁹ Study, § 1, p. 13.

²⁰ *Id.* § 6, pp. 9, 43.

²¹ *Id.* § 1, p. 13; § 4, pp. 10-11. Moreover, customers are permitted to apply for a hardship waiver if they cannot pay these modest amounts, and many arbitration provisions offer to pay them for the customer if requested or unconditionally. *Id.* § 2, pp. 58-59; § 5, pp. 12, 76-77.

²² *Id.* § 4, p. 10.

²³ *Id.* § 5, pp. 13, 41. Customers were also awarded attorneys' fees in 14.4% of the disputes resolved by arbitrators; the largest award of customer attorneys' fees was \$37,275. *Id.* § 5, p. 79.

²⁴ *Id.* § 6, p. 49 n. 85.

²⁵ \$1.1 billion divided by 34 million equals \$32.35 per class member.

²⁶ Study, § 1, pp. 13-14; § 6, p. 37.

are marginal at best and are filed not to benefit putative class members, but with the intention of driving an individual settlement. (Of course, even marginal or frivolous class actions require the defendant company to incur substantial defense costs up to the point of settlement, withdrawal, or dismissal. Therefore, all customers pay for the cost of defending and managing such suits in the form of higher prices or impact on services as such expenses have to be funded.)

Moreover, according to the Study, only 15% of the class actions studied obtained final class settlement approval.²⁷ In the class settlements that required the putative class members to submit a claim form, the weighted average claims rate was only 4%, because 96% of the potentially eligible putative class members failed to submit claims and therefore did not receive a settlement award.²⁸ In addition, even those minuscule claims rates fell by 90% if documentary proof was required to be submitted along with the claim.²⁹

The Study also shows that customers are more likely to obtain decisions on the merits in arbitration than they are in class action litigation. None of the 562 class actions studied by the Bureau went to trial.³⁰ By contrast, the Study found that of 341 cases resolved by an arbitrator, in-person hearings were held in 34% of the cases, and an arbitrator issued an award on the merits in about one-third of the cases.³¹

Finally, the statistic that dwarfs all others is the amount paid to class action attorneys. The Study found that attorneys' fees awarded to class counsel in settlements during the period studied amounted to a staggering \$424,495,451—*almost half a billion dollars*—in that relatively short period.³² The Bureau's findings confirm the conclusions reached by the U.S. Chamber of Commerce, Institute for Legal Reform in a December 2013 empirical study of class actions titled, "Do Class Actions Benefit Class Members?"³³ The Chamber analyzed 148 putative consumer and employee class action lawsuits filed in or removed to federal court in 2009. Consistent with the Bureau's Study, the Chamber's report found, *inter alia*, that—

- Not one of the class actions studied ended in a final judgment on the merits for the plaintiffs. And none of the class actions went to trial, either before a judge or a jury.

²⁷ *Id.* § 1, p. 14.

²⁸ *Id.* § 1, p. 17, § 8, p. 30.

²⁹ *Id.* § 8, p. 31.

³⁰ *Id.* § 6, pp. 7, 38.

³¹ *Id.* § 5, pp. 11-12.

³² *Id.* § 8, p. 33.

³³ A link to the report is available at <http://www.instituteforlegalreform.com/resource/study-class-actions-benefit-lawyers-not-consumers/>.

- The vast majority of cases produced no benefits to most members of the putative class—even though in a number of those cases the lawyers who sought to represent the class enriched themselves in the process.
- Over one-third (35%) of the class actions that were resolved were dismissed voluntarily by the plaintiff. Many of those cases settled on an individual basis, resulting in an award only to the individual named plaintiff and the lawyers who brought the suit, with the class members receiving nothing.
- Just under one-third (31%) of the class actions that were resolved were dismissed by a court on the merits, and the class members received nothing.
- For those cases that settled, there was often little or no benefit for class members. Moreover, few class members ever received those benefits, particularly in consumer class actions.

The close correlation between the Study and the Chamber's data reveals an empirical consensus that class actions benefit consumers' lawyers but not the consumers themselves. Both reports confirm that in class actions: (1) the vast majority of customers receive no benefit whatsoever from being a class member; (2) any economic benefit to individual class members in a class settlement is insignificant; and (3) the merits of the dispute are rarely reviewed or resolved. By contrast, the Study shows that customers can receive significant economic benefits in arbitration; they receive those benefits in months rather than years at little or no expense; and their disputes are resolved on the merits.

4. *The Study Dispels Key Misconceptions about Consumer Arbitration*

Plaintiffs' class action attorneys and consumer advocates contend that arbitration is unfair to consumers because (a) arbitration is a barrier to class actions, because it imposes individual arbitration or dissuades class actions from being brought; (b) very few consumers actually use arbitration to resolve disputes; (c) the arbitration provisions are contained in form contracts which give customers no choice but to arbitrate; and (d) companies have an unfair advantage in arbitration, because they are "repeat players" before the arbitration organizations they have named in their contracts. Study data, however, dispel each of these misconceptions.

a. Arbitration Is Not a Barrier to Class Actions

Substantial data in the Study contradict the argument that arbitration clauses are a barrier to class actions. The Study found that arbitration was a factor—and therefore potentially a barrier—in only 8% of the 562 class actions studied.³⁴ That is because the defendant companies moved to compel arbitration in only 94 of the 562 class actions (16.7%), and those motions were granted in only 46

³⁴ Study, § 6, p. 38 ("[a]ll claims against a company party were stayed or dismissed for arbitration in 8% of the [class] cases").

(one-half) of the class actions.³⁵ Thus, arbitration had no causal effect whatsoever on 92% of the class actions studied by the Bureau and, therefore, could not have been a barrier to consumers obtaining class relief in the overwhelming number of examples.³⁶ These data are particularly remarkable since in the middle of the time period studied (2010-2012), the U.S. Supreme Court upheld the validity of class action waivers in consumer arbitration agreements in *AT&T Mobility LLC v. Concepcion*.³⁷ The Study found that while *Concepcion* generated a “slight upward trend” in the use of arbitration provisions, “the increase has not been as dramatic as predicted by some commentators.”³⁸

Inasmuch as the Study demonstrates that arbitration agreements with class action waivers have only a very minor (8%) impact on consumer class actions, regulating availability or use of such agreements would not be in the public interest, nor is such regulation needed to protect the public. Conversely, if the Bureau were to over-regulate arbitration agreements or prohibit the use of class action waivers in such agreements, as some advocate, many companies would likely discontinue offering arbitration to customers. That would harm consumers, as they would lose the arbitration forum to resolve a dispute. They would be deprived of a valuable and time-tested procedure for economically, expeditiously, conveniently, and efficiently resolving individual customer disputes. Instead, they would be relegated to a procedure (class actions) in which they are likely to receive either no benefits at all or minuscule benefits that are delayed for years.

In fact, the Study clearly shows that the vast majority of class action lawsuits fail, not because the underlying disputes are sent to arbitration for individual disposition, but because they inherently lack merit and/or are not certifiable. The Study found that 35% of the class actions filed between 2010 and 2012 were withdrawn by plaintiffs and 25% were settled individually.³⁹ As noted in the Study, “[t]he most common outcome was a potential non-class settlement (typically, a withdrawal of claims by the plaintiff) Classwide judgment for consumers ... [was] the least frequent of the identified outcomes ... occurring in less than 1% of cases.”⁴⁰ The Study further found that “[c]lass certification rarely occurred outside the context of class settlement” and “[n]o class cases went to trial.”⁴¹

These statistics strongly suggest that the vast majority of the so-called “class actions” studied were one-off disputes that did not involve systemic issues and/or were otherwise not meritorious or

³⁵ *Id.* pp. 8-9, 57-58.

³⁶ *Id.* § 1, p. 14.

³⁷ See *AT&T Mobility LLC v. Concepcion*, 131 S. Ct. 1740 (2011).

³⁸ Study, § 2, p. 12.

³⁹ *Id.* § 1, pp. 13-14; § 6, p. 37.

⁴⁰ *Id.* § 6, p. 37.

⁴¹ *Id.* § 1, p. 14.

certifiable.⁴² They buttress the conclusion that there is little, if any, causal relationship between the success of consumer class actions and the presence of arbitration clauses in the customers' contracts, since most class actions fail due to their own inadequacies entirely unrelated to arbitration. Even as to the 92% of the class actions studied that were not ordered to be arbitrated, the Study demonstrates that class actions are an exceptionally poor vehicle for producing relief to customers. Moreover, these numbers effectively challenge the notion that class actions are an effective enforcement tool.

The data also debunk the oft-asserted argument from plaintiffs' lawyers that the mere presence of an arbitration clause discourages or inhibits customers from pursuing remedies.⁴³ Assuming *arguendo* that there are class actions that are not brought because the potential plaintiffs' contracts contained an arbitration clause with a class action waiver, there is no evidence to demonstrate that such class actions, if initiated, would have had a higher success rate than those that were filed and studied by the Bureau. Presumably, 60% of those class actions would never have resulted in any relief to putative class members, less than 1% of them would result in a judgment for the plaintiffs, and any relief to putative class members afforded by class action settlements would be insignificant compared to the benefits obtainable in arbitration.

In sum, it is not arbitration that is a barrier to customers obtaining meaningful relief in class actions. Rather, the evidence demonstrates that *it is class action litigation that may be precluding consumers from obtaining meaningful relief in arbitration.*

b. The Number of Consumer Arbitrations Initiated to Date Is Not a Meaningful Statistic

The Study noted a "relatively low" number (1,847) of arbitration proceedings filed by customers against financial services companies.⁴⁴ However, no inference should be drawn that customers prefer litigation to arbitration or that arbitration is an ineffective remedy compared to class actions. In reality, the vast majority of customer disputes are resolved by more direct methods without the need for arbitration or litigation, even small claims litigation.

Indeed, the Bureau has established a portal through which financial services companies resolve consumer disputes directly and without intervention, and the Bureau uses every opportunity to encourage consumers to file complaints through the portal. According to its website, from July 2011 through March 1, 2015, more than 558,800 consumer complaints and issues have been resolved in this manner.⁴⁵

⁴² Of course, even marginal or frivolous class actions must be defended, often at substantial cost to the defendant company.

⁴³ See, e.g., "Public Justice Comments to Bureau of Consumer Financial Protection In Response to Request for Information for Study of Pre-Dispute Arbitration Agreements," Docket No. CFPB-2012-0017, p. 17 (June 23, 2012) (urging the Bureau to study "the claims suppression effects of arbitration clauses").

⁴⁴ Study, § 5, p. 9.

⁴⁵ See http://files.consumerfinance.gov/f/201503_cfpb_complaints-by-the-numbers.pdf.

The Bureau's Consumer Response Annual Report also provides monetary relief information for companies that report such relief. This includes median relief of \$363 for 670 debt collection complaints, \$475 for 1,000 mortgage complaints, \$24 for 200 credit reporting complaints, \$105 for 3,060 bank account and service complaints, \$121 for 3,140 credit card complaints, \$200 for 270 private student loan complaints, and \$319 for 70 payday loan complaints.⁴⁶ In addition to the Bureau, a vast number of other federal agencies as well as state agencies such as state attorneys' general offices provide their own complaint portals, as do private entities such as the Better Business Bureau.

The fact that the number of consumer arbitrations is relatively small can also be explained by the following facts: (a) for almost two decades consumer advocates have sent consistently negative messages about arbitration to dissuade consumers from arbitrating;⁴⁷ (b) consumer arbitration is still "the new kid on the block" compared to litigation;⁴⁸ (c) government enforcement actions, including vigorous regulatory and supervisory activities by the Bureau,⁴⁹ reduce the field for consumers to bring private actions;⁵⁰ (d) individuals are turning increasingly to on-line arbitration and mediation resources to resolve small-dollar customer complaints (*see* note 9 *supra*); and (e) the Bureau has done little to educate consumers about the many benefits that arbitration can offer. With respect to this latter point, the Study found that over 75% of consumers surveyed said they do not know whether their credit card agreement contained an arbitration clause. The Bureau can play an important role in rectifying that situation by having its Consumer Education and Engagement division educate customers about the relative costs and benefits of arbitration and litigation—particularly class action litigation.

c. Customers Have Choices Regarding Arbitration

The Study found that 85% of credit card issuers (covering 47% of the market) and 92.3% of banks (with 56% of insured deposits) do not include arbitration provisions in their customer contracts.⁵¹ Clearly, customers who prefer not to have an arbitration provision in their account agreement can choose companies that do not offer arbitration programs. These include four of the ten largest credit card issuers (Bank of America, Capital One, Chase, and HSBC), which before 2009

⁴⁶ CFPB, Consumer Response Annual Report (January 1-December 31, 2014), p. 43, available at http://files.consumerfinance.gov/f/201503_cfpb_consumer-response-annual-report-2014.pdf.

⁴⁷ For example, the consumer advocacy organization Public Justice states on its website that "[o]ur Mandatory Arbitration Abuse Prevention Project is the acknowledged national leader in the battle against corporate efforts to use arbitration" *See* <http://www.publicjustice.net/what-we-do/access-justice/mandatory-arbitration>.

⁴⁸ *See* Prepared Remarks of Bureau Director Cordray at the March 10, 2015 Arbitration Field Hearing, p. 1 (although the Federal Arbitration Act was passed in 1925, "[a]rbitration clauses were rarely seen in consumer financial contracts until the last twenty years or so").

⁴⁹ *See* discussion at pages 18-20 of this letter.

⁵⁰ The Study identified 1,150 consumer financial enforcement actions filed between 2008 and 2012 by state, municipal, and federal entities. Of those, only 15% had one or more matching class action litigations. Study, § 9, p. 14.

⁵¹ *Id.* § 1, pp. 9-10; § 2, pp. 7, 9, 14.

included arbitration provisions in their account agreements but no longer do so.⁵² Moreover, at least 25% of those contracts that contain arbitration provisions also provide the customer with a contractual right to reject the arbitration provision, typically within 30 to 60 days of entering the contract, without affecting any other provision in the contract.⁵³

d. Companies Do Not Have an Unfair Advantage in Arbitration as “Repeat Players”

The Study found that almost all of the arbitration proceedings involved companies with repeat experience in the forum. However, that was counter-balanced by the fact that counsel for the consumers were also usually repeat players in arbitration.⁵⁴ Moreover, in 81% of the arbitrations in which customers were awarded affirmative relief, the company was a “repeat player,” but the customer prevailed anyway.⁵⁵

B. Important Issues that Warrant Additional Study

The Associations strongly urge the Bureau to conduct additional research on several important issues before making policy decisions regarding whether restricting or prohibiting consumer arbitration clauses would be in the public interest.

First, the Bureau should study consumer satisfaction with the arbitration process. The Bureau’s telephone survey of 1007 consumers merely purported to explore consumers’ “default assumptions” concerning arbitration and intentionally excluded consumers who had actually

⁵² *Id.* § 2, pp. 10-11.

⁵³ *Id.* § 2, p. 31. Scores of federal and state courts have enforced arbitration provisions on the basis that it permitted the consumer to opt out. See, e.g., *Circuit City Stores, Inc. v. Ahmed*, 283 F.3d 1198 (9th Cir. 2002); *Circuit City Stores, Inc. v. Najd*, 294 F.3d 1104, 1108 (9th Cir. 2002); *Marley v. Macy’s South*, No. CV 405-227, 2007 WL 1745619, at *3 (S.D. Ga. June 18, 2007); *Providian National Bank v. Screws*, 894 So. 2d 625 (Ala. 2003); *Tsadilas v. Providian National Bank*, 13 A.D.3d 190, 786 N.Y.S.2d 478 (N.Y. App. Div. 1st Dep’t 2004), *appeal denied*, 5 N.Y.3d 702, 832 N.E.2d 1189, 799 N.Y.S.2d 773 (June 4, 2005); *Webb v. ALC of West Cleveland, Inc.*, No. 90843, 2008 WL 4358554 (Ohio Ct. App., 8th App. Dist. Sept. 25, 2008); *Pivoris v. TCF Financial Corp.*, No. 07-C 2673, 2007 U.S. Dist. LEXIS 90562 (N.D. Ill. Dec. 7, 2007); *SDS Autos, Inc. v. Chrzanowski*, Case No. 1D06-4293, 2007 WL 4145222 (Fla Ct. App., 1st Dist. Nov. 26, 2007); *Honig v. Comcast of Ga., LLC*, Civil Action No. 1:07-cv-1839-TCB, 537 F. Supp. 2d 1277 (N.D. Ga. Jan. 31, 2007); *Davidson v. Cingular Wireless, LLC*, No. 2:06-cv- 00133, 2007 WL 896349, at *6 (E.D. Ark. Mar. 23, 2007); *Martin v. Delaware Title Loans, Inc.*, No. 08-3322, 2008 WL 444302 (E.D. Pa. Oct. 1, 2008); *Columbia Credit Services, Inc. v. Billingslea*, No. B190776, 2007 WL 1982721 (Cal. Ct. App. July 10, 2007); *Eaves-Leanos v. Assurant, Inc.*, No. 07-18, 2008 WL 1805431 (W.D. Ky. Apr. 21, 2008); *Enderlin v. XM Satellite Radio Holdings, Inc.*, No. 06-0032, 2008 WL 830262 (E.D. Ark. March 25, 2008); *Crandall v. AT&T Mobility, LLC*, No. 07-750, 2008 WL 2796752 (S.D. Ill. July 18, 2008); *Guadagno v. E*Trade Bank*, No. CV 08-03628 SJO (JCX), 2008 WL 5479062 (C.D. Calif. Dec. 29, 2008); *Magee v. Advance America Servicing of Ark, Inc.*, No 6:08-CV-6105, 2009 WL 890991 (W.D. Ark. April 1, 2009); *Clerk v. ACE Cash Express, Inc.*, No. 09-05117, 2010 U.S. Dist. LEXIS 7978 (E.D. Pa. Jan. 29, 2010).

⁵⁴ Study, § 1, p. 12; § 5, p. 10 & n. 16.

⁵⁵ *Id.* § 5, p. 67.

participated in an arbitration proceeding.⁵⁶ Both logic and common sense dictate that the Bureau should seek to measure consumer satisfaction with arbitration as it is an essential factor to be considered in an analysis of whether consumer arbitration is in the public interest.

As the Study acknowledges, there is precedent for studying this issue.⁵⁷ For example, in 2005 Harris Interactive conducted an online poll of 609 individuals who had participated in an arbitration proceeding in which a decision was reached.⁵⁸ That poll concluded, *inter alia*, that (1) arbitration was widely seen as faster (74%), simpler (63%), and cheaper (51%) than going to court; (2) two thirds (66%) of the participants said they would be likely to use arbitration again, with nearly half (48%) saying they were extremely likely to do so, and even among those who lost, one-third said they were at least somewhat likely to use arbitration again; (3) most participants were very satisfied with the arbitrators' performance, the confidentiality process, and its length; and (4) although winners found the process and outcome very fair and losers found the outcome much less fair, 40% of those who lost were moderately to highly satisfied with the fairness of the process, and 21% were moderately to highly satisfied with the outcome.

The Associations submit that, notwithstanding the Bureau's assertion that it is difficult to find consumers who have personal experience with both arbitration and litigation,⁵⁹ the opinions of consumers who have experienced the arbitration process are more valuable than the opinions of the consumers questioned in the Bureau's telephone survey who had never participated in an arbitration. The Associations believe that the Bureau's survey greatly diminished the value and relevance of the data as well as the Study as a whole.

Second, the Bureau should continue to study the benefits, if any, that individual class members receive in class action settlements. The Study reports data on the benefits of class actions in aggregate terms, failing to disclose the small sums that individual class members receive. Based upon the Bureau's finding that aggregate cash payments to "at least 34 million consumers" during the period studied were "at least \$1.1 billion,"⁶⁰ the Associations estimate that the average cash payment received by individuals in a settlement class was a mere \$32.35. That figure pales by comparison with the \$5,389 that the average customer received in arbitration.⁶¹ In addition, the Bureau should conduct a survey of consumers who have gone through class action litigation. Such a survey would shed much light on the issue of consumer satisfaction with class actions.

⁵⁶ *Id.* § 3, p. 4 ("[w]e opted not to explore consumer satisfaction with arbitration (or litigation proceedings)").

⁵⁷ *Id.* § 3, p. 5 n. 5.

⁵⁸ See Harris Interactive, *Survey of Arbitration Participants* (April 2005), available at <http://www.adrforum.com/rcontrol/documents/ResearchStudiesAndStatistics/2005HarrisPoll.pdf>.

⁵⁹ Study, § 3 p. 5.

⁶⁰ *Id.* § 1, pp. 16-17, § 8, pp. 27-28.

⁶¹ *Id.* § 5, pp. 13, 41.

While the Associations have sought to make apples-to-apples comparisons between arbitration and class action litigation based upon the Study's aggregate data, the Study itself attempts to shy away from doing so. Instead, the Study urges readers to exercise "caution in drawing conclusions as to how well consumers or companies fare in arbitration as compared to litigation."⁶² It reiterates that "[c]omparing outcomes across litigation and arbitration is especially treacherous" and "quite challenging."⁶³ If that is so, then what was the basis for the Bureau's press release for the March 10 field hearing, which emphasized the benefits of class actions over arbitration?⁶⁴ More importantly, what basis could there be for any regulation that would prohibit or materially limit consumer arbitration provisions in financial services contracts if the Bureau is unable to demonstrate clearly and convincingly that individual consumers fare worse in arbitration than they do in class action litigation?

The fact that the Bureau has acknowledged that in 60% of the putative class actions studied, class members recovered absolutely nothing makes it incumbent on the Bureau to analyze the amount that individual class members received in the 15% of the class actions that received final settlement approval. Any regulation by the Bureau that is based upon the alleged superiority of class actions as a means of resolving customer disputes must be supported by specific data showing that customers fare better in class actions than in arbitration. Such data are presented nowhere in the Study. In fact, the data in the Study show that arbitration is superior to class actions in terms of financial recovery for consumers (\$5,389 versus \$32.35).

Third, the Bureau should conduct additional analysis of whether the use of consumer arbitration provisions by companies lowers the costs of the goods and services these companies provide to customers and, conversely, whether the elimination of arbitration provisions or of class action waivers within them would increase the costs of goods and services to customers. The results of the Study on this issue were inconclusive as the Bureau found "little empirical evidence" and a "lack of a statistically significant effect."⁶⁵ The Bureau acknowledged that "we have not specifically isolated and studied the effect of removing arbitration clauses on the pricing of small issuers," and further acknowledged that "our analysis cannot be interpreted as establishing that companies did not save money from their use of pre-dispute arbitration clauses."⁶⁶

The Associations believe that this merits further study. Congress has recognized the extraordinary costs and burdens that companies are forced to incur in defending class actions, even the costs of defending against frivolous and marginally meritorious lawsuits. In enacting the Class Action Fairness Act of 2005, Congress found, *inter alia*, that—

⁶² *Id.* p. 7.

⁶³ *Id.* § 6, p. 4.

⁶⁴ See <http://www.consumerfinance.gov/newsroom/cfpb-study-finds-that-arbitration-agreements-limit-relief-for-consumers/>.

⁶⁵ Study, § 10, pp. 5, 16.

⁶⁶ *Id.* p. 16.

[C]orporate defendants are forced to settle frivolous claims to avoid expensive litigation, thus driving up consumer prices.

* * *

Because class actions are such a powerful tool, they can give a class attorney unbounded leverage, particularly in jurisdictions that are considered plaintiff-friendly. Such leverage can essentially force corporate defendants to pay ransom to class attorneys by settling—rather than litigating—frivolous lawsuits.

* * *

Judge Richard Posner of the United States Court of Appeals for the Seventh Circuit has explained, “Certification of a class action, even one lacking merit, forces defendants to stake their companies on the outcome of a single jury trial, or be forced by fear of the risk of bankruptcy to settle even if they have no legal liability [Defendants] may not wish to roll these dice. That is putting it mildly. They will be under intense pressure to settle.” Hence, when plaintiffs seek hundreds of millions of dollars in damages, basic economics can force a corporation to settle the suit, even if it is meritless and has only a five percent chance of success.⁶⁷

If there is a correlation between a company’s use of arbitration and the costs of the goods and services it supplies to customers, any regulation that eliminated the arbitration provision or its class action waiver could cause companies to incur substantially increased dispute resolution costs that could drive up the cost of the goods and services they provide to customers, the purported beneficiaries of such regulation. Basic economic theory dictates that if companies’ litigation costs increase, there will be corresponding pressure to increase revenue or reduce value. Many courts and commentators have so concluded.⁶⁸

Fourth, the Bureau should study the impact of recent U.S. Supreme Court decisions, such as *Comcast Corp. v. Behrend* and *Wal-Mart Stores, Inc. v. Dukes*, which make it more difficult for

⁶⁷ Senate Report No. 14, The Class Action Fairness Act of 2005, 109th Congress, 1st Sess., 2005 WL 627977, at *14, 20-21 (Feb. 28, 2005).

⁶⁸ See, e.g., *Metro East v. Quest*, 294 F.3d 294, 297 (7th Cir.), cert. denied, 537 U.S. 1090 (2002) (The “benefits of arbitration are reflected in a lower cost of doing business that is passed along to customers. That is because by limiting discovery and dealing with individual rather than class claims it “curtails the cost of the proceedings and allows swift resolution of small disputes.”); *Provencher v. Dell*, 409 F. Supp. 2d 1196, 1203 n. 9 (C.D. Cal. 2006) (“it is likely that consumers actually benefit in the form of less expensive computers reflecting Dell’s savings from inclusion of the arbitration clause in its contracts”); *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585 (1991) (“it stands to reason that passengers containing a forum clause ... benefit in the form of reduced fares ...”); Stephen J. Ware, *Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements*, 2001 J. Disp. Resol. 89, 91-93 (2001); Richard A. Posner, *Economic Analysis of Law* 7 (6th ed. 2003).

plaintiffs to obtain class certification.⁶⁹ The Associations believe that these decisions decrease the likelihood that putative class members will benefit from the class proceedings, which in turn supports arbitration as a preferred method in the first instance for consumers to resolve their disputes with companies.⁷⁰

Fifth, the Bureau should consider whether the government enforcement section of the Study, which excludes the bulk of the Bureau's own enforcement and supervisory actions, should be updated to include the Bureau's enforcement and supervisory actions from January 1, 2013, to date and to take account of anticipated future enforcement activities. The Study examined federal and state enforcement actions from January 1, 2008, through December 31, 2012.⁷¹ However, the Bureau did not report its first enforcement action until July 2012, and it has reported 47 enforcement actions in 2013, 2014 and to date in 2015.⁷²

Although the Bureau has been in operation less than four years, it would appear that its regulatory and supervisory activities are supplying what consumer advocates argue are the goals of class actions—providing redress for large numbers of consumers and the regulation of corporate behavior. Since the record of the Bureau's regulatory and enforcement activities is just beginning to emerge, the Study should be updated to consider the Bureau's enforcement activities from January 2013 to date. We believe they are reshaping the government enforcement landscape and significantly decreasing the alleged “enforcement” need for class actions. In July 2014, the Bureau stated on its

⁶⁹ *Comcast Corp. v. Behrend*, 133 S. Ct. 1426 (2013); *Wal-Mart Stores, Inc. v. Dukes*, 131 S. Ct. 2541 (2011). See also C. Fisk & E. Chemerinsky, “The Failing Faith in Class Actions: *Wal-Mart v. Dukes* and *AT&T Mobility v. Concepcion*,” 7 Duke J. of Const. Law & Pub. Policy 73 (2011) (“[i]n *Wal-Mart v. Dukes* ... the Supreme Court revamped the law concerning ... Rule 23 of the Federal Rules of Civil Procedure, allowing businesses to insulate themselves from class action suits”); R. Bone, “Class Actions and Access to Justice,” 82 Geo. Wash. L. Rev. 651, 654 (2014) (as a result of *Wal-Mart* and *Comcast*, “class certification has become more difficult to obtain”).

⁷⁰ Moreover, in *Spokeo, Inc. v. Robins*, No. 13-1339 (*cert. granted* April 27, 2015), the Supreme Court agreed to review whether a plaintiff who cannot show any actual harm from a violation of the Fair Credit Reporting Act (FCRA) nevertheless has standing under Article III of the U.S. Constitution to sue for statutory damages in federal court. The consequences of the Supreme Court's eventual decision will likely extend significantly beyond FCRA litigation and affect numerous other statutes and the viability of class actions where alleged technical violations did not cause any actual harm. In addition to the FCRA, such statutes include the Truth in Lending Act, the Telephone Consumer Protection Act, the Electronic Fund Transfer Act, the Fair Debt Collection Practices Act, the Homeowners Protection Act, the Fair Housing Act, the Credit Repair Organizations Act, the Employee Retirement Income Security Act, the Lanham Act, the Americans with Disabilities Act, and the Video Privacy Protection Act. The Supreme Court's ruling could also discourage the filing of class actions under those statutes. In countless class actions in federal court, the plaintiffs' class action bar has obtained recoveries despite the absence of actual injury to the named plaintiffs and class members. In addition, the Supreme Court recently agreed to review whether an unaccepted offer of complete relief to the named plaintiff made prior to certification of a class moots not only the plaintiff's individual claims, but also the class action and deprives the court of federal subject matter jurisdiction. See *Campbell-Ewald Company v. Gomez*, No. 14-857 (*cert. granted* May 18, 2015). A decision in that case could also make class actions harder to sustain.

⁷¹ Study, § 9, p. 9.

⁷² See <http://www.consumerfinance.gov/administrativeadjudication/>.

website: “To date, our enforcement actions have resulted in \$4.6 billion in relief for roughly 15 million consumers harmed by illegal practices.”⁷³ The Bureau also reported in its *Supervisory Highlights* of Winter 2015 that “recent supervisory resolutions [by the Bureau] have resulted in remediation of approximately \$19.4 million to more than 92,000 consumers.”⁷⁴ Its more recent *Supervisory Highlights* of Summer 2015 report an additional \$11.6 million to more than 80,000 consumers for a total of \$31 million to 172,000 consumers for the combined periods. Analyzing just the enforcement action statistics, the Bureau’s enforcement efforts have resulted in an average payment of \$305 to each consumer, approximately 10 times the \$32.35 received by the typical putative class member in the class action settlements studied by the Bureau.

In addition, the Bureau has remedies and resources not available to plaintiffs’ class action lawyers, such as the Civil Penalty Fund.⁷⁵ Moreover, unlike class action lawsuits, when the Bureau acts, there is less potential conflict between consumers and the attorneys representing them in the ultimate resolution of the case. In private class action litigation, counsel for the class seeks a sizeable percentage of any recoveries obtained (\$424,495,451, almost half a *billion* dollars, in attorneys’ fees in the limited class action data studied by the Bureau).⁷⁶ Notably, the \$4.6 billion in consumer relief provided by the Bureau’s enforcement activities through July 2014 was not reduced by a half-billion dollars to pay attorneys’ fees.

Updating the Study to include these statistics, and anticipated future enforcement and regulatory activities by the Bureau, is critically important since the Bureau’s robust enforcement activities reduce the need for class actions as a mechanism to protect consumers or discipline proscribed behavior. In the Study, the Bureau analyzed the extent of overlap between government enforcement and private class actions involving consumer financial issues. The Study concluded that “we were unable to find an overlapping private class action complaint in 88% of the enforcement actions.”⁷⁷ Thus, when the Bureau acts, it potentially eliminates or reduces the need for private class actions. Reducing the supposed need for class actions should also reduce any concerns that arbitration agreements may be harming customers because they impair class actions. Any new regulation of consumer arbitration before the impact of the Bureau’s enforcement activities on class actions is determined, and future enforcement activities by the Bureau are taken into account, would therefore be myopic.

Sixth, the Bureau should attempt to evaluate qualitatively the class actions it studied to determine whether the disputes involved were of a nature that would be likely to lead to certification. The Study seems to assume that if a class action is filed, it must be serious and legitimate for purposes

⁷³ See <http://www.consumerfinance.gov/blog/category/bureau-milestones/>.

⁷⁴ See *Supervisory Highlights* (Winter 2015) at <http://www.consumerfinance.gov>. The study notes that remediation numbers represent remedial actions that have been completed “since the publication of the last issue of the *Supervisory Highlights* and during the period under review,” but does not indicate the date of the prior *Supervisory Highlights*.

⁷⁵ See <http://www.consumerfinance.gov/budget/civil-penalty-fund/>.

⁷⁶ Study § 8, p. 33.

⁷⁷ *Id.* § 9, p. 4.

of comparing class actions to arbitration. As discussed above, however, the Bureau's own statistics reveal that 60% of the class actions studied were settled individually or were withdrawn by the plaintiffs.

These statistics are inconsistent with the Bureau's assumption about the legitimacy of class actions, and they challenge the conclusion that class actions are useful as an enforcement tool. Even the finding that 15% of the class actions received final settlement approval does not establish that the class actions were certifiable, since many companies settle to avoid the enormous cost, burden, and distraction of protracted class action proceedings and the discovery process. At the very minimum, the Bureau should review the pleadings in the class actions it studied and report on the percent, if any, that involved disputes that were adequately systemic in nature and therefore reasonably likely to result in class certification.

Seventh, the Bureau should study whether and how a regulation affecting consumer arbitration would impact the ever-burgeoning national and international market of online dispute resolution services. (*See note 9 supra*).

Finally, because financial consumer arbitration is in its relative infancy, the Bureau should study analogous areas, such as employment arbitration, in which the use of arbitration has a lengthier history. Several earlier studies have concluded that employees fare well in arbitration and have high levels of satisfaction with the arbitral process. For example—

- One study dealing with AAA employment arbitration found that employees won 73% of the arbitrations they initiated and 64% of all employment arbitrations (including those initiated by employers).⁷⁸
- A study that compared the results in employment arbitration with the results in federal court during the same period of time found that 63% of employees won in arbitration compared to 15% of employees who won in federal court. Awards to employees in arbitration were on average 18% of the amount demanded versus 10.4% of the amount demanded in court. The study also demonstrated that while arbitration awards to employees were on average lower than judgments to employees in court, the outcome for employees was still better in arbitration because of their higher win-rates of arbitration and the shorter duration of arbitration compared to court proceedings.⁷⁹
- In yet another study, it was reported that employees won 51% of arbitrations, while the EEOC won 24% of cases in federal court.⁸⁰

⁷⁸ Lisa B. Bingham, "Is There a Bias in Arbitration of Nonunion Employment Disputes? An Analysis of Active Cases and Outcomes," 6 *Int'l J. Conflict Management* 369, 378 (1995).

⁷⁹ L. Maltby, "Private Justice: Employment Arbitration and Civil Rights," 30 *Colum. Hum. Rights L. Rev.* 29, 46-48 (1998).

⁸⁰ G. Baxter, "Arbitration in Litigation for Employment Civil Rights?," 2 *Vol. of Individual Employee Rights* 19 (1993-94).

- Another study reported that employees won 68% of the time before the AAA as contrasted with only 28% of the time in litigation.⁸¹
- A study examining employment arbitration in California concluded that consumers prevailed 71% of the time.⁸²
- A report comparing arbitration and litigation of employment claims found that higher-compensated employees (*i.e.*, those with annual incomes of \$60,000 or more) obtained slightly higher awards in arbitration before the AAA than in court.⁸³
- A study compared the results of employment discrimination cases filed and resolved between 1997 and 2001 in the Southern District of New York versus arbitrations conducted by the NASD and NYSE. Employees prevailed 33.6% of the time in court versus 46% of the time in arbitration. The median damages award was \$95,554 in court versus \$100,000 in arbitration. The median duration was 25 months in court versus 16½ months in arbitration. The study also found that of over 3,000 cases filed in court, only 125 (2.8%) went to trial.⁸⁴
- A study of 171 employment arbitration cases filed with the AAA in 1992 concluded that there was no basis for believing that the arbitrators would favor employers who were repeat players.⁸⁵

III. CONCLUSION

The Associations believe that the Bureau's Study, inadequate as it is in many respects, nevertheless clearly supports a conclusion favoring pre-dispute arbitration agreements. We urge the Bureau to recognize and give full credit to the many pro-arbitration findings in the Study and to the other issues raised in this letter when it begins its policy deliberations. Moreover, we urge the Bureau to solicit public comment on the Study so that all interested stakeholders will have an opportunity to express their views on the important issues presented and amplify the record of information available before the Bureau decides whether to initiate a rulemaking. Without doing so, we do not believe that the Bureau, based upon the evidence presented to the public, can meet the test established by Congress for imposing new rules to limit, restrict, or otherwise prohibit consumer arbitration, an effective avenue for redress relied upon each year by many consumers.

⁸¹ W. Howard, "Arbitrating Claims of Employment Discrimination," *Disp. Res. J.* Oct-Dec 1995, at 40-43.

⁸² "Consumer and Employment Arbitration in California: A Review of Website Data Posted Pursuant to Section 1281.96 of the Code of Civil Procedure," California Dispute Resolution Institute (August 2004), available at www.mediate.com/cdri/cdri_print_Aug_6.pdf.

⁸³ T. Eisenberg & E. Hill, "Arbitration and Litigation of Employment Claims: An Empirical Comparison," *Disp. Resol. J.* Nov. 2003 – Jan. 2004, at 44.

⁸⁴ M. Delikat and M. Kleiner, "An Empirical Study of Dispute Resolution Mechanisms: Where Do Plaintiffs Better Vindicate Their Rights?," *Disp. Resol. J.* Nov. 2003 – Jan. 2004, at 56.

⁸⁵ L. Bingham, "Is there a Bias in Arbitration of Nonunion Employment Disputes? An Analysis of Actual Cases and Outcomes," 6 *Int'l J. of Conflict Mgmt.* 369 (1995).


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TESTIMONY OF
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BEFORE THE SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT OF THE
COMMITTEE ON FINANCIAL SERVICES
UNITED STATES HOUSE OF REPRESENTATIVES

HEARING
“EXAMINING THE CFPB’S PROPOSED RULEMAKING ON ARBITRATION: IS IT
IN THE PUBLIC INTEREST AND FOR THE PROTECTION OF CONSUMERS?”

MAY 18, 2016

Jason Scott Johnston
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 Testimony before the Subcommittee on Financial Institutions and Consumer Credit of the
 Committee on Financial Services
 United States House of Representatives
 May 18, 2016

Thank you for giving me the opportunity to testify before you today on the CFPB's May 5, 2016 Proposed Rulemaking on Arbitration.

I am the Henry L. and Grace Doherty Charitable Foundation Professor of Law at the University of Virginia Law School. One of my core areas of research activity and expertise is the regulation of consumer financial products and in particular the analysis of alternative methods of consumer dispute resolution. In this work, I utilize my training as both a lawyer and as an economist (obtaining both my J.D. and PhD in economics from the University of Michigan). As a consultant to the Mercatus Institution of George Mason University, in September, 2015, I produced (along with my co-author, Todd Zywicki of George Mason) a publicly available Research Report entitled "The Consumer Financial Protection Bureau's Arbitration Study: A Summary and Critique." Our paper is cited and discussed by the CFPB in its proposed rulemaking, and my testimony today at some points draws directly upon our "Summary and Critique" Report. I have even more recently posted online the first of several forthcoming papers analyzing data on all consumer class actions filed in the Northern District of Illinois over the period 2010-2012. The first paper, a draft entitled "High Cost, Little Compensation, No Harm to Deter: New Evidence on Class Actions under Federal Consumer Protection Statutes" is available online at <http://ssrn.com/abstract=2777618>. In my testimony, I refer in a few places to data on consumer class actions under federal consumer protection statutes that is discussed in that paper.

The CFPB proposes to "prohibit companies from putting mandatory arbitration clauses in new contracts that prevent class action lawsuits." According to the CFPB, "the proposal would open up the legal system to consumers so they could file a class action or join a class action when someone else files it. Under the proposal, companies would still be able to include arbitration clauses in their contracts. However, for contracts subject to the proposal, the clauses would have to say explicitly that they cannot be used to prohibit consumers from being part of a class action in court."

The CFPB justified this proposal by the findings in its March, 2015 Arbitration Study. According to the CFPB, its "study found that class actions provide a more effective means for consumers to challenge problematic practices by these companies. According to the study, class actions succeed in bringing hundreds of millions of dollars in relief to millions of consumers each year and cause companies to alter their legally questionable conduct. The study showed that at least 160 million class members were eligible for relief over the five-year period studied. Those settlements totaled \$2.7 billion in cash, in-kind relief, and attorney's fees and expenses. In addition, these figures do not

include the potential value to consumers of class action settlements requiring companies to change their behavior. However, where mandatory arbitration clauses are in place, companies are able to use those clauses to block class actions.”

The CFPB set out two benefits from its proposed ban on mandatory arbitration clauses that prohibit class actions. First, it said that “With class action lawsuits, consumers have opportunities to obtain relief from the legal system that, in practice, they otherwise would not receive.” Second, the rule would have a deterrent effect by “incentivizing companies to comply with the law to avoid group lawsuits.” A third benefit discussed by the CFPB accrues not from the ban but from a separate aspect of the proposal that would require companies that use arbitration clauses to submit any claims filed and awards issued in arbitration to the CFPB. The Bureau would also collect correspondence from arbitration administrators regarding a company’s non-payment of arbitration fees and its failure to adhere to the arbitration forum’s standards of conduct. According to the CFPB, “the collection of these materials would enable the CFPB to better understand and monitor arbitration. It would also provide insight into whether companies are abusing arbitration or whether the process itself is fair.”

In this testimony, I will explain how that rather than demonstrating the benefits of the recently proposed ban, the CFPB’s 2015 Arbitration Study strongly suggests that consumer arbitration before the American Arbitration Association (AAA) is a fast, fair, low cost and highly effective means of awarding relief to consumers. Moreover, while the CFPB’s study showed that in aggregate, millions of class action members received over a billion dollars in compensation under class settlements, that aggregate class payout cannot be compared with the arbitration outcomes to which the CFPB had access. Moreover, the CFPB’s own study showed that in typical class action settlements, a very small fraction of the class receives any compensation at all. As supplemented by my own ongoing work with data on all consumer class actions filed in a representative federal district court (the Northern District of Illinois) over the 2010-2012 period, the accumulating evidence is that aside from a few highly unusual gigantic class action settlements, in the typical class action settlement, a small fraction of consumers are compensated, attorney fees often dwarf the total amount paid to the class, and there is either no evidence of any real deterrent effect or – for the most common class action in both my dataset and the CFPB’s, one arising under a federal consumer protection statute – the settling plaintiff did not even allege harm.

It must be stressed that no general conclusions about the effectiveness of arbitration versus class actions can yet be reached by anybody. We simply need more empirical evidence about both arbitration and class action outcomes. The CFPB’s 2015 Arbitration Study gathered lots of evidence, but it failed to even gather data on what may well be the most important empirical question for policy design purposes: whether arbitration is a more accurate method of compensation than class action settlements, where accuracy means awarding compensation when and only when the consumer has a valid complaint under statute or common law.

1. Why Accuracy in Dispute Resolution is Crucial to Both Fairness and Efficiency

The accuracy of a dispute resolution system determines both its fairness and its deterrent value. In an ideal system, a consumer recovers damages if and only if a financial defendant has violated a statutory or common law duty to the consumer. If a company ends up making payments even when it has done nothing wrong, then not only do those payments unfairly take money away that could go to the company's shareholders, customers and employees, the payments may also create perverse incentives that harm consumers. After all, if frivolous or spiteful consumer complaints – those where the financial services provider has done no wrong -- end up generating liability anyway, then while a firm still has an incentive to identify and respond to valid consumer complaints – to keep the business of such customers – denying groundless complaints generates costs that may far exceed the value of the business of such complaining customers.

Basic economic theory predicts that firms would try to identify and deny services to consumers likely to raise such bad faith complaints. If firms are unable to accurately identify such customers *ex ante*, then a system that forces firms to make payments even when they have done no wrong imposes a tax on firms simply for doing business. The bigger the firm – the larger the number of its customers and the number of transactions it engages in – the bigger is this *de facto* tax. But like every tax, some one has to pay it.

No system of liability and compensation is perfect. Even the best system will sometimes transfer money from firms to consumers when the firm has done nothing wrong, and conversely sometimes fail to order such a transfer when the firm has indeed violated a statutory or common law duty owed to the consumer. The most important public policy question regarding the choice between arbitration and class actions is how well and at what cost each system performs in minimizing the social costs of these two types of errors.

2. Perhaps the Main Finding in the CFPB's Study is that through Market Choices, Consumers Themselves Incentivize Firms to Respond Quickly and Fairly to Valid Consumer Complaints

The CFPB's 2015 Study reports the results of a survey in which the CFPB asked consumers what they would do if they complained to a credit card company about a charge that the company had incorrectly assessed on their bill. Fewer than 2 percent of the respondents said that they would seek legal advice or consider filing a lawsuit. But almost 60 percent of those surveyed said that they would cancel their account with that credit card company and take their business elsewhere.

Companies clearly seem to take this threat seriously. Evidence discussed by Todd Zywicki and I in our recent critique of the CFPB's 2015 Study is that at least one medium sized bank in Texas grants refunds between about 60 and 90 percent of the time when consumers complain about fees for things such as wire transfers and inactive accounts. Clearly there is a big market sanction for firms that do not invest adequately to resolve

consumer complaints in a fair and speedy way, and the vast majority of consumers say they punish firm who fail to make such investments and end up denying valid complaints.

It should be noted that in its rulemaking, the CFPB opines that the variation in refund rates across bank branch offices in the data reported by Johnston and Zywicki likely reflects the practice by companies of giving refunds to profitable consumers but not to those who are unprofitable. While we do not know what explains variation in refund rates across branch offices, the simplest explanation is that it likely reflects variation in the rate at which consumers raise valid complaints about fees. And of course inasmuch as consumers who raise groundless complaints are not the ones that firms want to keep, granting relief only to valid complaints is fully consistent with the goal of furthering profitability. The CFPB holds to a worldview in which fairness to consumers is inconsistent with firm profitability. Especially in the world of lightning fast mass consumer communication over the internet where millions of consumers share their perception of whether a financial firm is fair, it seems much more likely that fairness to consumers supports firm profitability.

3) Because the CFPB's Report Shows that AAA Arbitration can be an Effective Means of Resolving Consumer Disputes and that Arbitration can Enhance Firm Incentives to Fairly Resolve Consumer Complaints, an Outright Ban on Arbitration Clauses Precluding Class Action Relief is not Warranted

Given this market incentive for firms to treat consumers fairly, the question is how class actions and arbitration compare as mechanisms for complementing market incentives. That is, the relevant policy question is how arbitration and class actions compare as devices for getting compensation to consumers who have suffered a real wrong at the hands of financial services providers, but wrongs that the market does adequately incentivize providers to correct, so that firms must be made to pay when they otherwise would not.

One kind of comparison between class actions and arbitration, invited by the CFPB's 2015 Study, is to compare class action settlements with actual claim awards in arbitration. The CFPB's 2015 Report reported a widely publicized number which the recent rulemaking repeats: that from class action settlements, over the 2008-2012 period, over 11 million consumers received over \$1.1 billion in compensation. By comparison, the CFPB found that over the 2011-2012 period, only 32 consumers succeeded in getting awards in AAA arbitration – comparable to a damage award in litigation -- and that those awards totaled \$172,433. Putting the obvious bias in comparing totals from class action settlements over a five-year period with arbitral awards for two years, the entire comparison is invalid. One cannot compare arbitral awards to class action settlements. This is an apples to oranges comparison that is highly misleading and can only lead to bad public policy. One can properly compare class action damage awards to arbitration damage awards, or class action settlement amounts to arbitration settlement amounts, but not settlements to damage awards.

The CFPB could not draw the proper comparison – between class action settlements and arbitration settlements – because the AAA apparently refused to give the CFPB access to arbitration settlement amounts. Before rushing to condemn the AAA for its lack of transparency, one must recognize that all AAA settlements are in individual consumer arbitrations. Likewise, the terms of individual litigation settlements in state and federal trial courts are not publicly available.

What the AAA did reveal to the CFPB about individual arbitrations, however, shows that arbitration likely generated payments to consumers most of the time, with the CFPB classifying a full 57% of all consumer arbitration filings as either known to or likely to have settled. With another 6 percent of consumers getting an award from the arbitrator, while the CFPB did not know the amount of these settlements, it did learn that 63 percent of the time, consumers receive some payment after filing a claim before the AAA. In arbitrations where consumers did receive awards, the average award was \$5389, a substantial amount that clearly would justify filing the lawsuit.

The CFPB also found that arbitration is so cheap and procedurally simple and yet fair that consumers do not need to pay a lawyer to get such payouts. Firms that use AAA for arbitration must abide by the AAA's "Consumer Due Process Protocol." This ensures the fairness of AAA arbitration, among other ways by guaranteeing arbitrator neutrality and by requiring that the arbitration take place within a reasonable distance of the consumer's home (indeed, the CFPB found that the median consumer traveled only 15 miles to the AAA arbitration, with an average distance traveled of 30 miles). AAA arbitrations are cheap, with the consumer paying only a \$200 filing fee, and informal, with claims under \$10,000 resolved by default based only on the documents submitted or at most a telephone hearing. As a consequence, even when telephone hearings are held – the most procedurally complex of all AAA arbitrations -- consumers get relief in less than 5 months. Because AAA arbitration is so cheap and informal, even though the CFPB found that most (63 percent) of consumers had counsel, it also found that those without counsel do just about as well in terms of arbitration outcomes as consumers with counsel. The CFPB found that while AAA consumer claimants with counsel got settlements at slightly higher rates (40 percent versus 34 percent), consumers without counsel did much better in actually winning cases decided by an arbitrator, with a win rate of 14 percent being a full seven times higher than the 2 percent win rate of consumers with counsel.

With all these positive findings about the potential benefits of arbitration, why did the CFPB conclude that consumers cannot be contractually bound to arbitrate rather than possibly become a member of a future class action? The answer seems to come in two parts: First, that truly small dollar consumer claims are not feasible in arbitration, and second, that such claims can and often are effectively redressed by class action lawsuits. It is true that the CFPB's 2015 Study found only 23 consumer claims or about 2 percent of all claims sought less than \$1000 (the threshold used by the CFPB to define a small dollar claim). As pointed out by Johnston and Zywicki, the fraction of such small dollar claims in the CFPB's arbitration dataset is (statistically) significantly smaller than the 3.5% rate at which such claims appear in publicly available AAA data for the entire

2009-2014 period. This suggests that the financial products arbitrations studied by the CFPB may be different than AAA arbitrations generally.

One way that they may be different is that according to the CFPB's own study, about 33 per cent of all the arbitrations it studied were brought under federal consumer protection statutes that award statutory damages without proof of harm.¹ Under such statutes, such as the Fair Credit Reporting Act, consumers get between \$500 and \$1500 per violation alleged (or per consumer). As consumers typically seek maximum statutory damages (there is no reason not to do so), claims under these statutes almost always allege at least \$1000 in damage and so would not be classified as "small dollar" by the CFPB.

It is true that this leaves two-thirds of the arbitrations studied by the CFPB which are made under state statute or common law. However, the state statute most commonly invoked in the arbitrations studied by the CFPB was a state consumer protection statute, and a strong majority of such state statutes award not just compensatory damages but also statutory and even punitive treble damages. Of the 723 arbitrations studied by the CFPB that did not make claims under a federal statute, fully 372 (or 51 percent) arose under such statutes. Claims under these statutes would not be classified as "small dollar" simply because the statute authorizes statutory and treble damages far exceeding the small dollar \$1000 threshold. If we add up all the arbitrations studied by the CFPB arising under federal or state consumer protection statutes that award statutory and/or treble and punitive damages, we get 707, or about 70 percent of all arbitrations studied that could not possibly be classified as small dollar simply because they raised statutory claims. If we compare 23 small dollar claims to the remaining 382 claims remaining that could even possibly be small dollar, we find that small dollar claims are a healthy 6 percent of the total.

It has been argued that even though AAA consumer arbitration is cheap, speedy and informal, with a \$200 filing fee it is still too costly for it to be rational for a consumer to pursue a really small claim, one less than \$200. This forgets that arbitration is contractual. By contract, firms can and have committed themselves to make fair offers to resolve internally such small claims or else risk much greater liability if a consumer claim is rejected and the consumer pursues arbitration. AT&T Mobility, for example guarantees claimants a minimum of \$10,000 and twice their attorney fees if they obtain an arbitration award that is greater than AT&T's last settlement offer. This provision effectively commits AT&T to make fair offers to preclude consumers from going to arbitration at all: that is, by making arbitration a potentially lucrative option for even a small claim consumer, the primary effect of the clause is to *incentivize fair offers by AT&T when the consumer first complains*.

Arbitration clauses such as this are still relatively new, and it is true that most firms do not have such clauses. However, rather than banning arbitration clauses, the CFPB could promulgate guidelines under which clauses such as AT&T's are given regulatory approval as presumptively fair and non-deceptive. In other words, the CFPB

¹ See CFPB Arbitration Study, Section 5, p. 47 (March, 2015).

should create incentives for pro-consumer market-driven contract terms, rather than eliminating the market as a mechanism.

4. Class Action Settlements are a Costly Alternative to Arbitration that often Fail to Compensate Consumers and Transfer Money from Defendant Firms in Cases Where there is no Wrongdoing to Deter

Having clarified that compared with the proper sample of non-statutory claims, small dollar claims in arbitration may be more significant than the CFPB Study suggested, it remains possible that small dollar claims are much more often to be seen in consumer class actions, and when seen in such actions, resolved in a way that generates significant compensation for consumers deterring firms from future wrongdoing.

First it must be noted that the vast majority of claims in consumer class actions in federal court arise under the same statutory damage – conferring federal consumer protection statutes found in the CFPB’s arbitration sample. According to the CFPB, class action complaints raising claims under these same federal consumer protection statutes made up about 72 per cent of all cases filed in federal district courts nationwide over the period 2010-2012. In my own sample of all consumer class actions filed in the Northern District of Illinois over the same period, cases arising under federal consumer protection statutes made up about 76 percent of all filings. Thus the vast majority of federal class action filings do not, by definition, involve small dollar claims.

In my study of consumer class actions filed in the Northern District of Illinois under federal consumer protection statutes, I found that over half were suits seeking statutory damages without even an allegation, let alone proof of harm to consumers. Thus such class actions are not only not small harm suits, they are actually no harm lawsuits. With no harm even alleged, class action settlements in such suits cannot be argued to serve either to deter firms from harm causing behavior or to compensate consumers for harm they have suffered.

Still, it must be granted that the 419 class action settlements reached between the years 2008 and 2012² that the CFPB studied included all types of filings, both those under federal and state consumer protection statutes awarding statutory damages and those under other statutes or state common law. Of these, the CFPB found 251 in which it was able to gather data on the amount paid to the class, but only 105 in which it was able to describe fully the key outcomes of a class action settlement: the amount actually paid to consumers in total, the amount of attorney fees, and the fraction of the consumer class that actually received any payment.³ The CFPB reported that on (unweighted) average, 21 per cent of the class received compensation, and that attorney fees also averaged 21 percent of the total relief granted to the class.

² The CFPB apparently gathered class action settlement data over a long period of time than for either its arbitration or litigation filing datasets.

³ CFPB Arbitration Study at Section 8, p. 30.

The CFPB's finding on the fraction of class members actually receiving compensation is somewhat higher than previous research has found, but it is not far out of line with my own ongoing research. My own investigation of class settlements under federal consumer protection statutes (in cases filed in the Northern District of Illinois over the period 201-2012) has found that claims rates vary a great deal across case types even within the sample of federal consumer protection statute class actions. For example, even under a single statute, such as the Fair Debt Collection Practices Act, claims rates vary from an average of only 16 percent in cases alleging a debt collector failed to follow statutory formalities to a full 47 percent in settlements of allegations that the debt collector attempted to collect on a legally uncollectible debt.

The CFPB finding that is entirely out of line with my own ongoing research is that attorney fees are only 21 percent of the aggregate payment to the class. In class settlements under federal consumer protection statutes that I have studied, attorney fees are rarely less than 75 percent of the total amount paid to the class and often are equal to three or four times that amount paid to the class. This finding indicates that class action settlements are an extremely costly and inefficient way of getting money to class members. To see how inefficient, one needs only to ask the question: "who would pay their lawyer three times the amount that they themselves actually recovered?"

The reason why the CFPB found to the contrary that attorney fees on average are only a small fraction of the amount paid to class members is because it computed an aggregate average, adding up fees in the numerator and payouts in the denominator across all types of class action settlements in its dataset. On this approach, the statistics from the biggest, monster class settlements swamp the numbers and conceal what are generally much higher fees and much lower payouts to the class. As the CFPB itself reported, attorney fees in the monster class settlements, those exceeding \$100 million, averaged only 9 percent of the total payout to consumers but averaged a full 57 percent in settlements of less than \$100,000. A mere six class action settlements with a total class payout of \$812 million and millions of class members make up 83% of total cash payouts in the 251 settlements studied by the CFPB. When the CFPB reported that attorney fees are a relatively low fraction of class payout and the class claims (or payout) rate relatively high, it was really saying that for six monster settlements, costs were low and payouts high.

The distorting effect of the biggest class action settlements is even more serious than this, because many of the largest settlements did not generate a cash payout to class members but instead brought other "nonmonetary" relief. In order to secure judicial approval of a settlement with primarily non-monetary relief, expert economist witnesses attach a big dollar value to such nonmonetary relief, but the "relief" is often illusory. For example, of the 350 million consumers that the CFPB reported as receiving relief of some kind, 190 million were part of a settlement of long running class litigation against the credit reporting agency Transunion.⁴ Class action lawyers received \$18 million in fees in

⁴ In re Transunion Privacy Litigation, MDL No. 1350 (N.D. Ill., Sept. 7 2008).

that settlement, but consumers only received six months of credit monitoring and credit reports, the latter of which were already free under the Fair Credit Reporting Act.

Thus as an instrument of actually compensating the class, class action settlements are likely to be much more costly and much less effective than is suggested by the data in the CFPB's 2015 Study. Matters are likely even worse on grounds of creating incentives for fair treatment of consumers. Under current legal standards for judicial approval of a class action settlement, the fact that a class action claim is weak on its substantive legal merits and so likely to lose were it ever actually adjudicated is an argument *supporting* judicial approval of the settlement. Indeed, the typical motion for judicial approval of a large, non-statutory class action settlement in my Northern District of Illinois dataset argues that it would be very costly to fully adjudicate the class claims on the merits and that the claim would face a high probability of being rejected on the merits after such an adjudication. Under this standard, *class action settlements are more likely to be approved, the greater the cost of proceeding with further discovery and litigation, and the more dubious and far-fetched is the plaintiff's claim that she has been wronged.*

Under the kind of AAA arbitration studied by the CFPB, there is no similar standard for a settlement. As far as we know from the CFPB's study, arbitrators either find for the consumer claimant, thus deciding that the consumer has been wronged under the relevant statutory or common law obligations of the parties, or a settlement is reached under the shadow of such a likely finding, or the consumer loses outright. As there are no costs to the consumer and very low costs to the company of proceeding to an actual judgment by the arbitrator (in AAA consumer arbitration, the company pays the arbitrator's fees), arbitral settlements are likely only when the consumer has a very good chance of being to have a valid complaint. Thus arbitral settlements are likely only in cases of actual wrongdoing by a financial services company.

5. Conclusion: Much too Little Is Known about Arbitration and Class Actions to Justify a Ban on Mandatory Arbitration

My conclusion is not that arbitration is necessarily superior to all forms of consumer class actions, but rather that far too little is yet known about the performance of either arbitration or consumer class actions to justify a ban on arbitration.



Statement of the U.S. Chamber of Commerce

**ON: Examining the CFPB's Proposed Rulemaking on
Arbitration: Is it in the Public Interest and for the
Protection of Consumers**

**TO: House Committee on Financial Services,
Subcommittee on Financial Institutions and Consumer
Credit**

**BY: Andrew Pincus, Partner, Mayer Brown, LLP (on
behalf of the U.S. Chamber of Commerce)**

DATE: May 18, 2016

1615 H Street NW | Washington, DC | 20062

The Chamber's mission is to advance human progress through an economic,
political and social system based on individual freedom,

The U.S. Chamber of Commerce is the world's largest business federation representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations. The Chamber is dedicated to promoting, protecting, and defending America's free enterprise system.

More than 96% of Chamber member companies have fewer than 100 employees, and many of the nation's largest companies are also active members. We are therefore cognizant not only of the challenges facing smaller businesses, but also those facing the business community at large.

Besides representing a cross-section of the American business community with respect to the number of employees, major classifications of American business—e.g., manufacturing, retailing, services, construction, wholesalers, and finance—are represented. The Chamber has membership in all 50 states.

The Chamber's international reach is substantial as well. We believe that global interdependence provides opportunities, not threats. In addition to the American Chambers of Commerce abroad, an increasing number of our members engage in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

The U.S. Chamber's Institute for Legal Reform is an affiliate of the Chamber dedicated to making our nation's overall civil legal system simpler, fairer, and faster for all participants.

**Testimony of Andrew Pincus,
Partner, Mayer Brown LLP on behalf of the U.S. Chamber of Commerce
Before the House Committee on Financial Services, Subcommittee on
Financial Institutions and Consumer Credit**

May 18, 2016

**CHAIRMAN NEUGEBAUER, RANKING MEMBER CLAY, AND MEMBERS OF THE
SUBCOMMITTEE:**

I am honored to appear before the Subcommittee today on behalf of the U.S. Chamber of Commerce and its Center on Capital Markets Competitiveness (“CCMC”) and the U.S. Chamber Institute for Legal Reform (“ILR”).

The U.S. Chamber of Commerce (the “Chamber”), the world’s largest business federation representing the interests of more than three million businesses of all sizes, sectors and regions, as well as state and local chambers and industry associations, is dedicated to promoting, protecting and defending America’s free enterprise system. The Chamber created CCMC to promote a modern and effective regulatory structure for capital markets to fully function in a 21st century economy. ILR is an affiliate of the Chamber dedicated to making our nation’s overall civil legal system simpler, faster, and fair for all participants.

The anti-arbitration rule proposed by the Consumer Financial Protection Bureau (the “Bureau” or “CFPB”)—if finalized by the Bureau and upheld by the courts—is bad for business and bad for consumers. The rule will harm consumers rather than help them by:

- Eliminating access to justice available to consumers through arbitration and relegating consumers to lawyer-controlled class actions that provide little benefit to consumers; and
- Increasing the cost to consumers of financial goods and services without any corresponding benefit.

Before explaining what arbitration is, how it benefits consumers, and why the Bureau's proposal will harm consumers, three preliminary points are important.

First, as a lawyer, nothing would make me happier than to tell this Subcommittee that our court systems are functioning well and that individuals have a realistic chance to vindicate their rights in court no matter how small the claim. Unfortunately, neither of those things are true. That is why we have a very significant access-to-justice problem in this country that is the topic of numerous articles in legal publications and appeals for charitable donations by bar associations and related groups.

I also would like to be able to say that the class action device effectively vindicates class members' interests and ensures that the interests of class members outweigh those of lawyers (both plaintiff and defense). But, again, experience with the class action system—as well as empirical analysis—leaves no doubt that the current system has major problems.

Arbitration addresses these flaws in our court systems, providing a fair, quick, and cheaper means of vindicating claims. It empowers individuals, freeing them from reliance on lawyers. And it harnesses technology to make dispute resolution easy to access and claims easy to prosecute.

Numerous government and business processes have been modified to use technology to increase efficiency and access. The same approach is appropriate for dispute resolution.

Second, the Subcommittee should view the Bureau's rulemaking in context. The rule is part of a widespread attack on arbitration, championed by those with a vested interest in the judicial litigation system—such as lawyers who are able to reap large fees from class actions. Although the Federal Arbitration Act, enacted in 1925, continues to embody Congress's preference for a "liberal federal policy favoring arbitration agreements," which the Supreme Court has upheld time and time again,¹

¹ *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 24-25 (1983). Over the past two decades, the Supreme Court has repeatedly enforced arbitration agreements. See, e.g., *Am. Express Co. v. Italian Colors Restaurant*, 570 U.S. ____ (2013); *Nitro-Lift Technologies, LLC v. Howard*, 568 U.S. ____ (2012); *Marmet Health Care Ctr., Inc. v. Brown*, 565 U.S. ____ (2012); *CompuCredit Corp. v. Greenwood*, 565 U.S. ____ (2012); *KPMG LLP v. Cocchi*, 565 U.S. ____ (2011); *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011); *Rent-A-Center, West, Inc. v. Jackson*, 561 U.S. 63 (2010); *14 Penn Plaza LLC v. Pyett*, 556 U.S. 247 (2009); *Preston v. Ferrer*, 552 U.S. 346 (2008) (Ginsburg, J.); *Buckeye Check Cashing, Inc. v. Cardagna*, 546 U.S. 440 (2006); *Citizens Bank v. Alafabco, Inc.*, 539 U.S. 52 (2003); *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681 (1996) (Ginsburg, J.); *Allied-Bruce Terminix Cos. v. Dohson*, 513 U.S. 265 (1995) (Breyer, J.).

there have been numerous Executive Branch efforts to undermine parties' rights to enforce contractual arbitration agreements:

- The Department of Education's March 11, 2016, announcement that it will take steps to end the use of pre-dispute arbitration agreements in enrollment agreements at institutions of higher learning²;
- The Department of Labor's proposed fiduciary duty rule, which restricts the use of arbitration³;
- The FCC's request, in a rulemaking ostensibly focused on consumer privacy, for comments on whether it should prohibit broadband internet service providers from using arbitration with their customers⁴; and
- The NLRB's efforts to invalidate arbitration clauses in employment agreements, which have been set aside by every appellate court to address the issue.⁵

In each of these circumstances, the agency alleges that only a court can properly vindicate the type of legal claim at issue, but those assertions are based on a theoretical assessment of the benefits of class actions that bears no relation to reality and on ignoring the benefits to consumers from arbitration.

Third, although the CFPB's proposal is framed as a requirement that consumers be able to participate in class actions, it will have the very same practical effect as a rule banning pre-dispute arbitration. That is because companies bear all, or virtually all of the costs of arbitration, and those costs can be significant—maintaining a pre-arbitration settlement process and covering all (or nearly all) filing fees, arbitrator fees, and the like. They are willing to do so because they don't have to pay

² U.S. Dep't of Educ., Press Release, U.S. Department of Education Takes Further Steps to Protect Students from Predatory Higher Education Institutions, Mar. 11, 2016, <http://www.ed.gov/news/press-releases/us-department-education-takes-further-steps-protect-students-predatory-higher-education-institutions>.

³ Definition of the Term "Fiduciary"; Conflict of Interest Rule-Retirement Investment Advice, 81 Fed. Reg. 20,945 (Apr. 8, 2016).

⁴ Protecting the Privacy of Customers of Broadband and Other Telecommunications Services, 81 Fed. Reg. 23,360, 23,393-94 (Apr. 20, 2016).

⁵ See, e.g., *D.R. Horton, Inc. v. NLRB*, 737 F.3d 344, 362 (5th Cir. 2013); *Sutherland v. Ernst & Young LLP*, 726 F.3d 290, 297 n.8 (2d Cir. 2013); *Owen v. Bristol Care, Inc.*, 702 F.3d 1050, 1055 (8th Cir. 2013); *Iskanian v. CLS Transp. Los Angeles, LLC*, 327 P.3d 129, 142 (Cal. 2014).

the litigation costs associated with class actions: all of their disputes are resolved in one system, arbitration.

No rational business will pay the costs associated with two systems. Forcing them to spend the millions in legal fees it costs to defend against class actions, and they will drop arbitration rather than voluntarily take on duplicative dispute resolution expenditures. Indeed, that is what companies did before the Supreme Court's 2011 *AT&T v. Concepcion* decision upheld the enforceability of class waivers—they wrote their arbitration clauses to eliminate arbitration if the law required them to defend against class actions.⁶

The CFPB's Unfair, Closed Study Process.

The critical policy question that the CFPB should have addressed is whether the benefits that consumers obtain from class actions are so great that it is worth sacrificing the benefits that consumers gain from arbitration. And, that question should have been assessed based on how class actions work in the real world, not how they are supposed to work on paper. The CFPB's study and proposed rule, instead, take it on faith that class actions are beneficial to American consumers. But that faith is deeply misguided. And, the Bureau's assessment of arbitration's benefits is similarly flawed.

The Bureau's approach was simply to follow the plaintiff's bar attacks on arbitration that rest entirely on theory, not reality. The claims that class actions provide "access to justice" and that arbitration can't do so are grounded in an assessment of these dispute resolution mechanisms are entirely disconnected from reality and an overly idealized view of class action litigation.

To evaluate the effect of the Bureau's proposal, it is essential to understand arbitration, class actions, and the real-world trade-offs associated with eliminating arbitration in favor of class actions.

The Bureau failed to undertake that inquiry.

⁶ Thus, one group of businesses explained to the Supreme Court in 2011 that, "when there is no assurance that all claims will be arbitrated in lieu of litigation, and a [company] must shoulder the additional costs of class action litigation, subsidizing the costs of individual arbitration is no longer a rational business option"; the only logical decision is to "disengage from arbitration altogether." Brief for CTIA—the Wireless Association as Amicus Curiae at 21, *AT&T Mobility LLC v. Concepcion*.

It is not surprising, therefore, that the effect of the CFPB's proposal is directly at odds with the Bureau's consumer-protection mission: the closed, nontransparent process that gave birth to the proposed rule was flawed from the start.

Congress directed the Bureau to study arbitration, and use the study's findings as the basis for any proposal to regulate arbitration. The Bureau's response was to solicit public comment once, at the outset of the study process, and never again for the three years that the study was underway. The Bureau never informed the public of the topics it had decided to study and never sought public comment on them—even though a number of commenters suggested that the Bureau utilize that procedure. The Bureau never convened public roundtable discussions on key issues, as many other agencies routinely do. And the Bureau never sought public input on its tentative findings.⁷

The product of this closed process is flawed in numerous respects. The Bureau's study:

- ignores the practical benefits of the procedures available in arbitration as compared to the court system for vindicating the types of disputes that consumers most often have;
- fails to consider the benefits that arbitration can provide to injured parties in a variety of contexts—benefits that plainly would accrue to consumers as well if they were not discouraged by plaintiffs' lawyers and others from invoking arbitration;
- fails to consider the reduced transaction costs resulting from arbitration, which under basic economic theory produce lower prices to consumers;
- exaggerates the supposed benefits of class actions to consumers and ignores the grossly disproportionate gains reaped by self-interested plaintiffs' lawyers; and

⁷ The Bureau staff would meet with interested parties and accept written submissions. But the staff refused to provide any information regarding the topics that the Bureau was studying or the timeline for its study process, and those one-way conversations therefore did not permit anything resembling meaningful input.

- ignores the significant role of government enforcement—particularly the CFPB’s own enforcement and supervision processes—in protecting consumers.

Indeed, more than eighty members of the House and Senate explained in their letter to the Bureau last summer regarding the study on which the proposed rule is based that:

the process that led to the Bureau’s Arbitration Study has not been fair, transparent, or comprehensive. The Bureau ignored requests from senior Members of Congress for basic information about the study preparation process. The Bureau also ignored requests to disclose the topics that would be covered by the study, and failed to provide the general public with any meaningful opportunities to provide input on the topics. Because the materials were kept behind closed doors, the final Arbitration Study included entire sections that were not included in the preliminary report that was provided to the public.

As a result, the flawed process produced a fatally-flawed study. Rather than focusing on the critical question—whether regulating or prohibiting arbitration will benefit consumers—and devising a plan to address the issues relevant to resolving that question, the Bureau failed to provide even the most basic of comparisons needed to evaluate the use of arbitration agreements.⁸

Two prominent academics recently conducted an independent analysis of the CFPB’s study, concluding that it “provides no foundation for imposing new restrictions or prohibitions on mandatory arbitration clauses in consumer contracts.”⁹ In particular, the study “fail[s] to support any conclusion that arbitration clauses in consumer credit contracts reduce consumer welfare or that encouraging more class

⁸ <http://www.cfpbmonitor.com/files/2015/06/McHenry-Scott-to-Cordray-Letter-re-Arbitration.pdf>

⁹ Jason Scott Johnston & Todd Zywicki, *The Consumer Financial Protection Bureau’s Arbitration Study: A Summary and Critique* 5 (Mercatus Ctr., George Mason Univ., Working Paper, Aug. 2015), available at http://www.law.gmu.edu/assets/files/publications/working_papers/LS1507.pdf.

action litigation would be beneficial to consumers and the economy.”¹⁰ The CFPB’s recent notice of proposed rulemaking offers no response to these scholar’s extensive critique.

The study’s flaws—and the tremendous amount of evidence ignored by the Bureau—are discussed in detail in the attached appendix.

What is Arbitration and how does it Work?

Everyone knows how courts are supposed to work. Who hasn’t watched *Law and Order* or *The Good Wife* or dozens of other television shows? Between television and high school civics, we have the impression that courts are places where people can, and do, receive justice. (As discussed below, that impression is far removed from the current reality of the court system.)¹¹

Arbitration seems more mysterious. But we’ve seen arbitration in operation too.

The People’s Court isn’t a court; it is arbitration, with Judge Wapner, and now Judge Milian, as the arbitrator. *Judge Judy* also resolves disputes as an arbitrator.¹²

Their common-sense approach is just how consumer arbitration works—the parties come in, present their cases informally, and the arbitrator rules. No complex procedures; a lawyer is not necessary (although lawyers can be used); and there is no obligation to take days off from work or family obligations to sit through lengthy proceedings and postponements—losing pay, while seeking justice—which court cases require.

And the process can even be simpler than the in-person hearings on TV. Arbitration employs web-based technology that allows claims to be filed and prosecuted online or with a telephonic hearing, at the consumer’s option.

The American Arbitration Association (“AAA”), for example, requires the business to bear most arbitration costs; many companies pay even the consumer’s

¹⁰ *Id.* at 6.

¹¹ See discussion beginning on Pg. 18.

¹² See *Kabia v. Koch*, 713 N.Y.S.2d 250, 253-55 (Civ. Ct. 2000) (holding that “The People’s Court” was an arbitration under New York law and noting that “Judge Judy” used a “similar” arbitration agreement).

share, which the AAA caps at \$200.¹³ The AAA offers hearings by telephone, and participants can file documents and otherwise communicate with the AAA and arbitrator through email.

And arbitration is fair—studies show that consumers and employees who use this efficient dispute-resolution system prevail in arbitration at least as frequently as, and often more frequently than, they do in court:

- A recent study by scholars Christopher Drahozal and Samantha Zyontz of claims filed with the AAA found that consumers win relief 53.3% of the time.¹⁴ By contrast, empirical studies that have sampled wide ranges of claims have similarly reported that plaintiffs win in state and federal court approximately 50% of the time.¹⁵
 - Drahozal and Zyontz found that “the consumer claimant[s] won some relief against the business more than half of the time,” and were generally awarded between 42% and 73% of the amount they claimed, depending on the size of the claim and how average recoveries were calculated (mean or median). The authors found little evidence for a purported “repeat player” effect. Consumers prevailed more than half the time against repeat and non-repeat businesses alike; prevailing claimants were “awarded on average an almost identical percent of the amount claimed” (approximately 52%). The authors concluded that any discrepancy could be explained by businesses becoming better at screening cases ahead of time to “settle meritorious claims and arbitrate only weaker claims.”¹⁶
- A study of 186 claimants who pursued employment arbitration in the securities industry concluded that employees who arbitrate were more likely to win their disputes than employees who litigate in federal court. The study found that 46% of those who arbitrated won, as compared to only 34% in litigation; the median monetary award in arbitration was higher; only 3.8% of the litigated

¹³ AAA, *Costs of Arbitration*, <https://www.adr.org/aaa/ShowPDF?doc=ADRSTAGE2026862>.

¹⁴ Christopher R. Drahozal & Samantha Zyontz, *An Empirical Study of AAA Consumer Arbitrations*, 25 Ohio St. J. on Disp. Resol. 843, 896-904 (2010).

¹⁵ See, e.g., Theodore Eisenberg et al., *Litigation Outcomes in State and Federal Courts: A Statistical Portrait*, 19 Seattle U. L. Rev. 433, 437 (1996) (observing that in 1991-92, plaintiffs won 51% of jury trials in state court and 56% of jury trials in federal court, while in 1979-1993 plaintiffs won 50% of jury trials).

¹⁶ Drahozal & Zyontz, 25 Ohio St. J. on Disp. Resol. at 898, 912-13.

cases studied ever reached a jury trial; and the arbitrations were resolved 33% faster than in court.¹⁷

- One study of 200 AAA employment awards concluded that low-income employees brought 43.5% of arbitration claims, most of which were low-value enough that the employees would not have been able to find an attorney willing to bring litigation on their behalf. These employees were often able to pursue their arbitrations without an attorney, and won at the same rate as individuals with representation.¹⁸
- A later study of 261 AAA employment awards from the same period found that for higher-income employees, win rates in like cases in arbitration and litigation were essentially equal, as were median damages. The study attempted to compare “apples” to “apples” by considering separately cases that involved and those that did not involve discrimination claims. With respect to discrimination and non-discrimination claims alike, the study found no statistically significant difference in the success rates of higher-income employees in arbitration and in litigation. For lower-income employees, the study did not attempt to draw comparisons between results in arbitration and in litigation, because lower-income employees appeared to lack meaningful access to the courts—and therefore could not bring a sufficient volume of court cases to provide a baseline for comparison.¹⁹
- Another study of arbitration of employment-discrimination claims concluded that arbitration is “substantially fair to employees, including those employees at the lower end of the income scale,” with employees enjoying a win rate comparable to the win rate for employees proceeding in federal court.²⁰

¹⁷ Michael Delikat & Morris M. Kleiner, *An Empirical Study of Dispute Resolution Mechanisms: Where do Plaintiffs Better Vindicate Their Rights?*, 58 Disp. Resol. J. 56, 58 (Nov. 2003 - Jan. 2004).

¹⁸ Elizabeth Hill, *Due Process at Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 Ohio St. J. on Disp. Resol. 777, 785-88 (2003) (summarizing results of past studies by Lisa Bingham that lacked empirical evidence proving the existence of an alleged “repeat player” and “repeat arbitrator” effect).

¹⁹ See Theodore Eisenberg & Elizabeth Hill, *Arbitration and Litigation of Employment Claims: An Empirical Comparison*, 58 Disp. Resol. J. 44, 45, 47-50 (Nov. 2003-Jan. 2004).

²⁰ See Elizabeth Hill, *AAA Employment Arbitration: A Fair Forum at Low Cost*, 58 Disp. Resol. J. 9, 13 (May/July 2003) (reporting employee win rate in arbitration of 43 percent); see also Eisenberg & Hill, 58 Disp. Resol. J. at 48 tbl. 1 (reporting employee win rate in federal district court during the same time period was 36.4 percent).

- In 2004, the National Workrights Institute compiled all available employment-arbitration studies and concluded that employees were almost 20% more likely to win in arbitration than in litigated employment cases. It also concluded that in almost half of employment arbitrations, employees were seeking redress for claims too small to support cost-effective litigation. Median awards received by plaintiffs were the same as in court, although the distorting effect of occasional large jury awards resulted in higher average recoveries in litigation.²¹
- Critics of arbitration sometimes point to a now-discredited report from the advocacy group Public Citizen²² as purported support for the assertion that arbitration is unfair. That report shows the folly of examining outcomes in arbitration without comparing them to analogous outcomes in court.
 - Public Citizen examined data about claims brought by creditors against consumer debtors and concluded from a high win rate for creditors that arbitration is biased. In those cases, however, the consumer often does not appear and does not contest the claim and is therefore liable either because he has defaulted or “because he owes the debt.”²³
 - A more rigorous empirical study showed that “consumers fare better” in debt-collection arbitrations than in court: “creditors won some relief before the AAA in 77.8 percent of individual AAA debt collection arbitrations and either 64.1 percent or 85.2 percent of the AAA debt collection program arbitrations,” depending on how the research parameters were defined. By contrast, in contested court cases creditors won relief against consumers between 80% and 100% of the time, depending on the court.²⁴

As one study published in the *Stanford Law Review* explained in surveying the empirical research, “[w]hat seems clear from the results of these studies is that the

²¹ National Workrights Institute, *Employment Arbitration: What Does the Data Show?* (2004), https://web.archive.org/web/20090423052708/http://www.workrights.org/current/cd_arbitration.html.

²² Public Citizen, *The Arbitration Trap*, Sept. 2007, <http://www.citizen.org/documents/ArbitrationTrap.pdf>.

²³ Sarah Rudolph Cole & Theodore H. Frank, *The Current State of Consumer Arbitration*, 15 Disp. Resol. Mag. 30, 31 (Fall 2008).

²⁴ Christopher R. Drahozal & Samantha Zyontz, *Creditor Claims in Arbitration and in Court*, 7 Hastings Bus. L.J. 77, 91, 97, 111-16 (Winter 2011).

assertions of many arbitration critics were either overstated or simply wrong.”²⁵ There simply is no empirical support for the contention that arbitration leads to unfair or subpar outcomes when compared with litigation in our overcrowded court system. Rather, the overwhelming weight of the available evidence establishes that arbitration allows consumers and employees to obtain redress faster, cheaper, and more effectively than they could in court.

Arbitration also has built-in fairness guarantees. The rules of arbitration organizations along with existing law protect consumers and employees against unfair procedures and biased arbitrators.

Thus, when courts find arbitration provisions unfair to consumers or employees under generally applicable principles, they do not hesitate to invalidate the agreements. For example, courts have repeatedly invalidated provisions of arbitration agreements that purported to impose:

- excessive costs and fees to the consumer or employee for accessing the arbitral forum;²⁶
- limits on damages that can be awarded by an arbitrator when such damages would be available to an individual consumer or employee in court;²⁷
- requirements that arbitration take place in inconvenient locations;²⁸

²⁵ David Sherwyn et al., *Assessing the Case for Employment Arbitration: A New Path for Empirical Research*, 57 Stan. L. Rev. 1557, 1567 (2005) (emphasis added).

²⁶ The Supreme Court has held that a party to an arbitration agreement may challenge enforcement of the agreement if the claimant would be required to pay excessive filing fees or arbitrator fees in order to arbitrate a claim. See *Green Tree Fin. Corp. v. Randolph*, 531 U.S. 79, 90-92 (2000). Since *Randolph*, courts have aggressively protected consumers and employees who show that they would be forced to bear excessive costs to access the arbitral forum. See, e.g., *Chavarria v. Ralphs Grocery Co.*, 733 F.3d 916, 923-25 (9th Cir. 2013) (refusing to enforce an arbitration agreement that required the employee to pay an unrecoverable portion of the arbitrator’s fees “regardless of the merits of the claim”); *Am. Express Co. v. Italian Colors Rest.*, 133 S. Ct. 2304, 2310-11 (2013) (reaffirming that a challenge to an arbitration agreement might be successful if “filing and administrative fees attached to arbitration . . . are so high as to make access to the forum impracticable” for a plaintiff). Courts also have reached the same conclusion under state unconscionability law. See, e.g., *Brinke v. Ohio State Home Servs., Inc.*, 2008 WL 4615578 (Ohio Ct. App. Oct. 20, 2008); *Liebrand v. Brinker Rest. Corp.*, 2008 WL 2445544 (Cal. Ct. App. June 18, 2008); *Murphy v. Mid-West Nat’l Life Ins. Co. of Tenn.*, 78 P.3d 766 (Idaho 2003).

²⁷ See, e.g., *Venture Cotton Coop. v. Freeman*, 395 S.W.3d 272 (Tex. Ct. App. 2013) (limit on damages and attorney’s fees under state consumer protection law); *Mortg. Elec. Registration Sys., Inc. v. Abner*, 260 S.W.3d 351, 352, 355 (Ky. Ct. App. 2008) (limited to “actual and direct” damages); see also *Carll v. Terminix Int’l Co.*, 793 A.2d 921 (Pa. Super. Ct. 2002) (limit on damages for personal injury); *Alexander v. Anthony Int’l, L.P.*, 341 F.3d 256 (3d Cir. 2003) (limit on punitive damages); *Wobbe v. Health Care & Retirement Corp. of Am.*, 977 So. 2d 630 (Fla. Dist. Ct. App. 2008) (limit on punitive damages); cf. *Am. Express Co.*, 133 S. Ct. at 2310 (explaining that federal law would require invalidating “a provision in an arbitration agreement forbidding the assertion of certain [federal] statutory rights”).

- biased procedures for selecting the arbitrator;²⁹
- unreasonably shortened statutes of limitations;³⁰ and
- “loser pays” provisions under which a consumer or employee might have to pay the full costs of the arbitration,³¹ or must pay the drafting party’s costs regardless of who wins.³²

Of course, the vast majority of arbitration agreements do not exhibit these sorts of defects; and the clear trend has been for companies to make arbitration provisions ever more favorable to their customers and employees. But, when courts find that overreaching occurs, they have not hesitated to strike down the offending provision.

In addition to the courts’ oversight of arbitration provisions, the leading arbitration forums provide additional fairness protections. The AAA and JAMS—the nation’s leading arbitration service providers—recognize that independence, due

²⁸ See, e.g., *Willis v. Nationwide Debt Settlement Grp.*, 878 F. Supp. 2d 1208 (D. Or. 2012) (travel from Oregon to California); *College Park Pentecostal Holiness Church v. Gen. Steel Corp.*, 847 F. Supp. 2d 807 (D. Md. 2012) (travel from Maryland to Colorado); *Hollins v. Debt Relief of Am.*, 479 F. Supp. 2d 1099 (D. Neb. 2007) (travel from Nebraska to Texas); *Phillyaw v. Platinum Enters., Inc.*, 54 Va. Cir. 364 (Va. Cir. Ct. Spotsylvania Cnty. 2001) (travel from Virginia to Los Angeles); see also, e.g., *Dominguez v. Finish Line, Inc.*, 439 F. Supp. 2d 688 (W.D. Tex. 2006) (travel from Texas to Indiana); *Swain v. Auto Servs., Inc.*, 128 S.W.3d 103, 108 (Mo. Ct. App. 2003) (travel from Missouri to Arkansas); *Pinedo v. Premium Tobacco Stores, Inc.*, 102 Cal. Rptr. 2d 435 (Ct. App. 2000) (travel from Los Angeles to Oakland).

²⁹ See, e.g., *Chavarria*, 733 F.3d at 923-25 (holding that an arbitration agreement was unconscionable and unenforceable when it “would always produce an arbitrator proposed by [the company] in employee-initiated arbitration[s],” and barred selection of “institutional arbitration administrators”); see also, e.g., *Murray v. United Food & Commercial Workers Int’l Union*, 289 F.3d 297 (4th Cir. 2002) (striking down an arbitration agreement that gave the employer the sole right to create a list of arbitrators from whom the employee could then pick); *Hooters of Am., Inc. v. Phillips*, 173 F.3d 933 (4th Cir. 1999); *Newton v. American Debt Services, Inc.*, 854 F. Supp. 2d 712, 726 (N.D. Cal. 2012) (refusing to enforce a provision that would have granted a company sole discretion to choose an “independent and qualified” arbitrator for its consumer disputes because, under the circumstances, there was no guarantee that the arbitrator would be neutral); *Roberts v. Time Plus Payroll Servs., Inc.*, 2008 WL 376288 (E.D. Pa. Feb. 7, 2008) (refusing to enforce provision that would have given employer sole discretion to select arbitrator, and instead requiring parties to select arbitrator jointly); *Missouri ex rel. Vincent v. Schneider*, 194 S.W.3d 853 (Mo. 2006) (invalidating provision giving president of a local home-builder association sole discretion to pick arbitrator for disputes between local home-builders and home buyers).

³⁰ See, e.g., *Zaborowski v. MHN Gov’t Servs., Inc.*, 2013 WL 1363568 (N.D. Cal. Apr. 3, 2013); *Adler v. Fred Lind Manor*, 103 P.3d 773 (Wash. 2004) (180 days); see also *Gandee v. LDL Freedom Enters., Inc.*, 293 P.3d 1197 (Wash. 2013) (refusing to enforce arbitration agreement in debt-collection contract that required debtor to present claim within 30 days after dispute arose); *Alexander*, 341 F.3d at 256 (same, for an employee); *Stirlen*, 60 Cal. Rptr. 2d at 138 (rejecting provision that imposed shortened one-year statute of limitations).

³¹ See *Gandee*, 293 P.3d at 1197; *Alexander*, 341 F.3d at 256; *Sosa v. Paulos*, 924 P.2d 357 (Utah 1996).

³² See, e.g., *In re Checking Account Overdraft Litig.*, MDL No. 2036, 485 F. App’x 403 (11th Cir. 2012); see also *Samaniego v. Empire Today LLC*, 140 Cal. Rptr. 3d 492 (Cal. Ct. App. 2012) (attorneys’ fees).

process, and reasonable costs to consumers are vital elements of a fair and accessible arbitration system. They, therefore, adhere to standards that establish basic requirements of fairness that provide strong protections for consumers and employees—and refuse to administer arbitrations unless the operative clause is consistent with those standards.

Arbitration's Benefits to Consumers

This fair, efficient arbitration system benefits consumers in multiple ways.

First, particularly in the consumer context, arbitration empowers injured parties by freeing them from dependence on lawyers—consumers can seek and obtain redress for the many claims for which a lawyer is too expensive or that lawyers are unwilling or unable to take on. Indeed, one study reported that a claim must be worth at least \$60,000; in some markets, this threshold may be as high as \$200,000.³³ Plaintiffs who brave the court system find that a hearing on their claims is long delayed by overcrowded dockets in our underfunded courts.³⁴

Most injuries that consumers suffer are small and individualized—excess charges on a bill, a defective piece of merchandise, and the like. These claims are too small to justify paying a lawyer to handle the matter; in any event, most consumers do not have the resources to do so. And, because they are individualized, they cannot be asserted in class actions because the governing standard (embodied in Federal Rule of Civil Procedure 23) requires that common issues predominate for a class to be certified. As Justice Breyer has recognized—in a decision joined by Justices Stevens, Souter, and Ginsburg—“the typical consumer who has only a small damages claim (who seeks, say, the value of only a defective refrigerator or television set)” would be

³³ Elizabeth Hill, *Due Process at Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 Ohio St. J. on Disp. Resol. 777, 783 (2003); Recommendations of the Minnesota Supreme Court Civil Justice Reform Task Force 10 (Nov. 23, 2011), <http://www.mnbar.org/sections/outstate-practice/11-23-11%20Civil%20Justice%20Reform.pdf>.

³⁴ In California, for example, repeated budget cuts have forced 52 courthouses and 202 courtrooms to close, prompting the state judiciary to warn that funding for the state's courts is no longer “enough to sustain a healthy [judicial system].” Judicial Council of Cal., *InFocus: Judicial Branch Budget Crisis*, available at <http://www.courts.ca.gov/partners/courtsbudget.htm>. Los Angeles County, the state's largest, reported this year that its remaining courts are facing “unmanageably high” workloads, which is producing “intolerable delay” in civil cases. Judicial Council of Cal., *2015 Budget Snapshot: County of Los Angeles* (Feb. 2015), available at http://www.courts.ca.gov/partners/-documents/County_Budget_Snapshot_Combined_2015.pdf.

left “without any remedy but a court remedy, the costs and delays of which could eat up the value of an eventual small recovery.”³⁵

Opponents of arbitration point to small claims court; but, that is not a viable alternative. State budget cuts have severely hobbled these courts and repeated adjournments of cases, together with elimination of night sessions and some court sessions altogether, require individuals to take off multiple days from work or family obligations—often imposing costs greater than the amount at issue.³⁶

Critics of arbitration sometimes express skepticism about arbitration’s benefits because there are relatively few consumer financial arbitrations. That analysis is wrong for several reasons. To begin with, the actual numbers aren’t clear. Most analyses look only at consumer arbitrations formally commenced before the American Arbitration Association, but there are other organizations providing this service.

Also, the attacks on arbitration take a toll, discouraging consumers from using it. Where arbitration has been supported and allowed to develop—under the auspices of the Kaiser Foundation health plan³⁷, for example, or in the employment context³⁸—it has been used with great frequency and success by claimants.

³⁵ *Allied-Bruce Terminix Cos., Inc. v. Dobson*, 513 U.S. 265, 281 (1995). Professor Peter Rutledge has observed that, without access to arbitration, consumers would be “far worse off, for they would find it far harder to obtain a lawyer, find the cost of dispute resolution far more expensive, wait far longer to obtain relief and may well never see a day in court.” Peter B. Rutledge, *Who Can Be Against Fairness? The Case Against the Arbitration Fairness Act*, 9 Cardozo J. Conflict Resolution 267, 267 (2008).

³⁶ See, e.g., Brian Lawson, *Proposed budget cuts for Alabama courts ‘crazy, devastating’*, AL.com (May 5, 2015), available at http://www.al.com/news/huntsville/index.ssf/2015/05/proposed_cuts_for_alabama_cour.html (quoting Alabama’s administrative director of courts as saying that as a result of proposed cuts to state courts, “Small claims courts . . . those dockets will be heavily decreased or suspended for who knows how long.”); Marisa Lagos, *Cutbacks Still Felt Deeply In California’s Civil Courts*, KQED (Mar. 11, 2015), available at <http://www2.kqed.org/news/2015/03/12/-court-budget-cuts-delay-justice> (“L.A. made 10 percent across-the-board cuts to court services in 2012, but it wasn’t enough. So the next year, they made further cuts. In all, 79 courtrooms were shuttered, limiting where people can contest traffic tickets or adjudicate small claims cases.”);

N.Y. Cnty. Lawyers’ Assoc., Task Force on Judicial Budget Cuts, *Courts in Crisis* 7 (Jan. 3, 2014), http://www.nycla.org/siteFiles/Publications/Publications1666_0.pdf (“[S]evere reduction in evening hours in Small Claims Court from four nights a week to one night in most boroughs [of New York City] and to only one or two nights a month in Richmond County makes the Small Claims Court basically unavailable to claimants who cannot take time off during the day to appear. In Brooklyn and Manhattan, it may now take up to several years to get a judgment.”).

³⁷ Annual Report of the Office of the Independent Administrator of the Kaiser Foundation Health Plan, Inc. Mandatory Arbitration System for Disputes with Health Plan Members, January 1, 2014 – December 31, 2014 at 44, <http://www.oia-kaiserarhb.com/pdfs/2014-Annual-Report.pdf> (reporting that almost 50% of the parties and attorneys who went through Kaiser arbitrations that year reported that the arbitration system was better than going to court, another 38% reported that it was the same as going to court—and only 14% reported it was worse).

Most importantly, virtually all arbitration programs have a pre-filing settlement process and the overwhelming majority of disputes are resolved before arbitration; because, the availability of arbitration gives individuals leverage to pressure companies to settle. If an individual's only threat is to "go to court," a company could refuse to settle, knowing that the judicial system is an unrealistic option for consumers because it is too expensive and difficult to navigate. These pre-filing processes do not show up in the AAA's statistics, but they generate hundreds of millions of dollars in relief for consumers—all of which was totally ignored by the CFPB, even though the agency was repeatedly asked to examine this benefit.

Second, companies increasingly are adopting consumer-friendly arbitration agreements that give consumers rights that are greater than those available in court. As the Solicitor General of the United States explained in its briefing before the Supreme Court in *American Express v. Italian Colors Restaurant*, "many companies have modified their agreements to include streamlined procedures and premiums designed to encourage customers to bring claims."³⁹ The government recognized that consumer-friendly clauses ensure that instances where individuals cannot bring their claims "remain rare." As the brief explained:

AT&T Mobility modified its arbitration agreement during the course of the litigation to include cost- and fee-shifting provisions and premiums designed to ensure that **customers could bring low-value claims on an individual basis**. These modifications left consumers **'better off under their arbitration agreement' than they would have been in class litigation**. And by obviating a potential objection to enforcement of the arbitration agreement, those modifications simultaneously served the company's interest in avoiding litigation.

That provision, for example, provided for "bounty payments" as an incentive for an individual to bring a claim in arbitration, and agreed not only to pay any attorney's fees that would be authorized by the underlying law, but double the

³⁸ See, e.g., Elizabeth Hill, *Due Process at Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 Ohio St. J. on Disp. Resol. 777, 824 (2003) (empirical study concluding that "AAA employment arbitration offers affordable, substantial, measurable due process to employees").

³⁹ Brief for the United States as Amicus Curiae Supporting Respondents at 28-29, *American Express Co. v. Italian Colors Restaurant*, 133 S. Ct. 2304 (2013) (No. 12-133), 2013 WL 367051 (emphasis added).

attorney's fees if the arbitrator awards more than the company's last pre-hearing settlement offer.

Third, consumers and employees also benefit through the systematic reduction of litigation-related transaction costs, which leads to lower prices for products and services and higher wages.

How does this work? Businesses face many costs in bringing products and services to market. On top of the ordinary costs of running a business, they must absorb costs of litigating business-related claims. The transaction costs of litigation are high; they include settlements, judgments resolving meritorious claims, and the costs of defending against *all* lawsuits. Because those transaction costs are lower in arbitration, businesses can reduce costs that otherwise inflate product and service prices and reduce the availability of margins that could pay for wage increases.

The CFPB's study tried to provide that businesses do not pass on cost savings from arbitration to consumers and employees, but that attempt was unpersuasive: as the academics who reviewed the CFPB's study concluded, the CFPB's findings on this point were plagued by "theoretical problems" and "technical failures," and they fly in the face of "[b]asic economic theory," which "predicts that competition forces firms to pass on to consumers [or employees] at least a portion of any cost decrease."⁴⁰

These are all significant benefits for consumers that will be eliminated by the Bureau's proposed rule. The Bureau's rule can only make sense, therefore, if the benefits to consumers from class actions significantly outweigh the benefits from arbitration that the rule would eliminate. That is not at all the case.

The Reality of Class Actions

Class actions in the federal court system turn fifty years old in 2016. That should be the occasion for a realistic assessment of the pluses and minuses of what in 1966 was a dramatic innovation in the law. Instead, class action proponents portray them as an unalloyed good, and some opponents say they are utterly worthless in both theory and practice.

⁴⁰ See Johnston & Zywicki, *supra* note 9, at 33-34.

Proponents of class actions argue that the process allows individuals to band together to obtain redress for injuries that are too small to litigate on their own. The class procedure, the theory goes, provides a route to vindicate claims too small to justify an individual lawsuit and allows courts to resolve claims efficiently.

Unfortunately, the reality of class actions today does not come close to fulfilling that promise.

Study after study confirms this fact:

- The CFPB's own review of class actions found that 87% provide *no* benefits to class members; the remaining class actions were settled, but the Bureau's data indicates that on average only 4% of class members obtained monetary relief—meaning that 96% got nothing. And, the data indicate that the average payment to a class member was \$32.35. Plaintiffs' lawyers, on the other hand, received an average of \$1 million per case.⁴¹
- A recent study of class action data by a professor at Emory Law School found that, although the pre-distribution description of settlements allocated 60% to the class and 37.9% to class members, the likely actual distribution of funds in many settlements resulted in only 9% of the funds going to class members.⁴²
- A new empirical study by Professor Jason Johnston of the University of Virginia Law School determined that 60-80% of filed class actions end with no payment to the class (depending on the type of claim); attorneys' fees therefore often amounted to 300-400% of the amount actually paid to class members.⁴³
- A study by my law firm found that two-thirds of resolved cases provided no benefit to class members; the remaining cases were settled, but the available data showed that a miniscule percentage of class members

⁴¹ See pages 4-5 of the Appendix to this testimony.

⁴² Joanna Shepherd, *An Empirical Survey of No-Injury Class Actions* (2016), available at <http://ssrn.com/abstract=2726905>.

⁴³ Jason Scott Johnston, *High Cost, Little Compensation, no Harm to Deter: New Evidence on Class Actions under Federal Consumer Protection Statutes* (2016), available at <http://ssrn.com/abstract=2777618>.

obtained payments—the maximum was 12% and for most of the settlements less than 2% of the class.⁴⁴

Note that these cases are virtually never litigated to a final merits determination. If the motion to dismiss is denied and a class is certified, the case is inevitably settled—meaning some number of meritless cases are ending in substantial payments (most of which go to the lawyers), because the larger downside risk of a loss and the cost of litigation leads defendants to settle even when they might win in the end.

Moreover, class actions are often marked by abusive behavior. Press reports and court decisions document abusive behavior by plaintiffs' lawyers, including possible under-the-table payments to convince individuals to serve as representative plaintiffs⁴⁵; use of payments to charities (termed "cy pres") to inflate the size of settlements in order to justify large fees to plaintiffs' attorneys⁴⁶; the use of relatives, employees, or other related parties to serve as class representatives who will do the bidding of the plaintiffs' lawyers⁴⁷ agreeing to settlements that provide class members with mere coupons or vouchers while guaranteeing the plaintiffs' lawyers hefty fees⁴⁸;

⁴⁴ Mayer Brown LLP, *Do Class Actions Benefit Class Members?* (Dec. 2013), available at <https://www.mayerbrown.com/files/uploads/Documents/PDFs/2013/December/DoClassActionsBenefitClassMembers.pdf>

⁴⁵ See, e.g., Daniel Fisher, *Collapse Of 5-Hour Energy Case Reveals The Secrets Of Class Action Lawyers*, *Forbes* (Nov., 17, 2015), available at <http://www.forbes.com/sites/danielfisher/2015/11/17/collapse-of-5-hour-energy-case-reveals-secrets/#9c14b4b1aa40>; *Swift v. First U.S.A. Bank*, 1999 WL 1212561, at *6 (N.D. Ill. Dec. 15, 1999) (refusing to certify class because plaintiffs' attorneys had initially agreed to pay lead plaintiff's husband a portion of their attorneys' fees as a "finder's fee"); had been Press Release, United States Dep't of Justice, Milberg Weiss Law Firm, Two Senior Partners Indicted in Secret Kickback Scheme Involving Named Plaintiffs in Class-Action Lawsuits (May 18, 2006), available at <http://online.wsj.com/public/resources/documents/milbergpress05182006.pdf> (announcing 20-count indictment against Milberg Weiss and two of its senior partners).

⁴⁶ See *Marek v. Lane*, 134 S. Ct. 8, 9 (2013) (Roberts, C.J., respecting the denial of certiorari) (noting the many "fundamental concerns surrounding the use of [cy pres] remedies in class action litigation"); *In re Baby Prods. Antitrust Litig.*, 708 F.3d 163, 175 (3d Cir. 2013) (vacating order approving settlement that would have given just \$3 million to class members and \$18.5 million to cy pres recipients, while awarding plaintiffs' attorneys \$14 million in fees); Alison Frankel, *When class money doesn't go to class members: new calls for SCOTUS review*, *Reuters* (Dec. 14, 2015), available at <http://blogs.reuters.com/alison-frankel/2015/12/14/when-class-money-doesnt-go-to-class-members-new-calls-for-scotus-review/>.

⁴⁷ See, e.g., *Eubank v. Pella Corp.*, 753 F.3d 718, 722, 724 (7th Cir. 2014) (Posner, J.) (holding that settlement should have been disapproved, in part because the lead named plaintiff was the father-in-law of the lead plaintiffs' attorney—which created a "grave conflict of interest" and "palpable" "impropriety"); *Apple Computer, Inc. v. Superior Court*, 126 Cal. App. 4th 1253, 1262 (2005) (disqualifying two law firms from serving as class counsel in a class action because the named plaintiff was a lawyer at one of the firms and because during a two-year period, the two firms had jointly filed ten class actions in which "an attorney from [one firm] or a relative of one of the attorneys was the named plaintiff").

⁴⁸ See, e.g., *Radosti v. Envision EMI, LLC*, 717 F. Supp. 2d 37, 46-48 (D.D.C. 2010) (class received vouchers toward future conferences put on by defendant; attorneys received nearly \$1.5 million in fees); *Bachman v. A.G. Edwards, Inc.*, 344 S.W.3d 260, 264-65 (Mo. Ct. App. 2011) (class received vouchers toward brokerage fees charged by defendant; attorneys received \$21 million).

and “clear sailing” agreements in which defendants agree not to challenge the plaintiffs’ lawyers’ fee requests—likely because the plaintiffs’ lawyers have “bargain[ed] away something of value to the plaintiff class,” their supposed clients.⁴⁹

One outspoken critic of arbitration—the *New York Times*—has devoted considerable space recently to attacking arbitration. Those stories are not only inaccurate on their own terms,⁵⁰ but also are particularly troubling because they simply assume the benefits of class actions without examining whether consumers actually realize any of those benefits.

But another *Times* reporter did take the time to examine a consumer class action and provided a case study of the abuse that is all too commonplace.⁵¹

The story examined a class action against Netflix and Walmart alleging violations of the antitrust laws. Prior to 2005, the two companies had been competitors in the DVD rental market. That year, they reached an agreement under which Walmart would stop renting DVDs and Netflix would stop selling them—in effect ending competition between the two in the DVD sales and rental markets. The plaintiffs who brought the class action alleged that the deal violated the antitrust laws because it was anticompetitive and inflated the price of Netflix subscriptions.

⁴⁹ See, e.g., *Makhan v. Davis*, 761 F.2d 893, 908 (2d Cir. 1985) (Newman, J., concurring).

⁵⁰ The *Times* stories were criticized by, among others, Yale Law Professor Stephen Carter, Forbes’ columnist Daniel Fisher, and legal expert Walter Olson. See Stephen Carter, *Arbitration is Everywhere and Not All Bad*, Bloomberg View (Nov. 3, 2015), available at <http://www.bloomberg.com/view/articles/2015-11-03/arbitration-is-everywhere-and-not-all-bad>; Daniel Fisher, New York Times “Expose” of Arbitration Clauses Leaves Lawyers in the Shadows, Forbes (Nov. 1, 2015), available at <http://www.forbes.com/sites/danielfisher/2015/11/01/new-york-times-expose-of-arbitration-clauses-leaves-lawyers-in-the-shadows/#510700466665>; Walter Olson, New York Times Assails Arbitration, Cato at Liberty (Nov. 2, 2015), available at <http://www.cato.org/blog/new-york-times-assails-arbitration>. The stories’ inaccuracies are detailed in several in-depth analyses by the U.S. Chamber Institute for Legal Reform. See *Dog Bites Man: New York Times Prefers Lawyer-Controlled Class Actions over Fair Arbitration that Enables Individuals to Protect Themselves* (Nov. 2, 2015), available at <http://www.instituteforlegalreform.com/resource/-dog-bites-man-new-york-times-prefers-lawyer-controlled-class-actions-over-fair-arbitration-that-enables-individuals-to-protect-themselves>; *New York Times Part 2: Arbitration Responsible for All of the World’s Ills (Well, Just About All)* (Nov. 4, 2015), available at <http://www.instituteforlegalreform.com/-resource/new-york-times-part-2-arbitration-responsible-for-all-of-the-worlds-ills-well-just-about-all>; *The New York Times Doesn’t Like Arbitration, But It Really Likes Plaintiffs’ Lawyers* (Jan. 7, 2016), available at <http://www.instituteforlegalreform.com/resource/the-new-york-times-doesnt-like-arbitration-but-it-really-likes-plaintiffs-lawyers>.

⁵¹ David Segal, A Little Walmart Gift Card for You, a Big Payout for Lawyers, N.Y. Times (Jan. 30, 2016), available at <http://www.nytimes.com/2016/01/31/your-money/a-little-walmart-gift-card-for-you-a-big-payout-for-lawyers.html?ref=business&r=0>.

Netflix fought the class action (and won on summary judgment); Walmart chose to settle. The headline touted by the plaintiffs' lawyers: "\$27 million settlement." But the details tell the real story.

Members of the class were entitled to choose between receiving a check for approximately \$12 or a Walmart gift card for the same amount.

And the lawyers? They got fees of \$6.8 million and expenses of \$1.7 million for a total of \$8.5 million.

A settlement in which lawyers got \$8.5 million for providing \$14 million in \$12 increments would be troubling by itself. But the \$14 million figure itself is an overstatement unless *all* of the gift cards were cashed. And, as the *Times* explained, "[w]e don't know" how many were cashed: "That information has not been publicly revealed." But, common sense suggests that many class members didn't use the gift cards.

Ted Frank, a critic of class-action settlements that favor lawyers over consumers, explained that gift cards were employed "to maximize the illusion of relief"—so that the lawyers' fee could be justified on the dollar amount of issued gift cards, not the dollar amount actually used by consumers.

Congress addressed this precise problem in the Class Action Fairness Act of 2005, targeting "coupon settlements" in which class members received a credit toward purchases of the defendant's products and the plaintiff lawyers' fee was based on the gross amount of coupons and therefore had no relationship to the real benefit to the class. The law says that plaintiffs' lawyers must be paid based on the value of the coupons *actually redeemed*, not the value of all the coupons made available by the defendant.

The *Times* also explained that this case is "positively pro-consumer compared with others"—for example, another case (on appeal) in which the settlement provided

\$6 million for charity, \$5.7 million for plaintiffs' lawyers and a mere \$345,000 for consumers. (The case is under appeal, so no one has been paid yet.) The reason the consumer side is so meager is that **less than 1 percent** of the 7.2 million class members actually submitted for

reimbursement. But the lawyers' fees were calculated based on the \$43 million that could have been disbursed if all eligible consumers had asked for a \$6 check.

As the *Times* consumer reporter put it, "Everybody won! O.K., not everybody."

The lack of real-world benefit to class members and other problems with class actions are not mere happenstance. They are a result of structural problems inherent in the current class action mechanism.

To begin with, many—probably a significant majority—of class actions today spring from the minds of lawyers, not from injured individuals. A *New York Times* profile⁵² of one prominent plaintiffs' lawyer discussed the lawyer's "investigative team, which consists of three lawyers and a computer analyst. The group's job, to put it plainly, is to find ways to sue companies." The lawyers then find individuals who fit the claim. As Professor Martin Redish has noted, this confirms that "[t]he real parties in interest in... [many] class actions are... the plaintiffs' lawyers."⁵³

Next, there is the problem that the interests of the class action lawyers and class members may not be aligned—as the *New York Times* story demonstrates. The lawyer's concern—at least in significant part—is on maximizing fees. That means finding claims that are easy to litigate, even if the particular "harm" alleged does not concern many, or even any, consumers.

There might be nothing wrong with that approach in theory—as long as there are effective checks to ensure that the lawyers' interest do not overwhelm the obligation to the (essentially absent and not-in-control) class members. Federal class action procedure assigns that role to the court, which must approve any settlement.

When both the defendant and plaintiffs' counsel are urging the court to approve the settlement as fair and reasonable, however, it is virtually impossible for the court to make an independent assessment of the underlying facts. The court's record is limited to what the parties put before it, and most overburdened judges are happy to see a settlement that removes a significant case from their docket. Certainly

⁵² Conor Dougherty, *Jay Edelson, the Class-Action Lawyer Who May Be Tech's Least Friendliest Man*, N.Y. Times (Apr. 4, 2015), available at http://www.nytimes.com/2015/04/05/technology/unpopular-in-silicon-valley.html?_r=1.

⁵³ Testimony of Martin H. Redish at 7, *Class Actions Seven Years After the Class Action Fairness Act* (June 1, 2012), available at <http://judiciary.house.gov/hearings/Hearings%202012/-Redish%2006012012.pdf>.

defense counsel cannot be expected to take a position regarding the allocation of proceeds between class counsel and the class.

In recent years, class members objecting to settlements—represented by independent counsel—have begun participating in settlement proceedings and urging judges to disapprove settlements that favor class counsel over class members. The *New York Times* story reports an instance of this activity.

The problem, however, is that courts only have the power to disapprove settlements. That leaves the defendant in a meritless class action with two choices: expend huge resources litigating the case, or pay more to settle in order to obtain court approval. Neither result benefits consumers, who must pay the bill in either event. The court cannot take the step that often would be most logical when a proposed settlement is rejected: dismiss the action because the settlement terms proffered by the parties indicate that the case has little merit.

For all of these reasons, class actions provide little real-world benefit to consumers.

The CFPB, and other arbitration opponents, argue that even if class actions do a poor job of providing compensation to injured consumers, they nonetheless are justified because the threat of class-action liability deters companies from violating consumer laws. That is simply false.

The rationale for deterrence is the common-sense idea that a party will not engage in wrongdoing if it believes that it will incur costs for acting wrongfully that it will not incur if it complies with the law. If those costs are incurred without regard to the wrongfulness of the underlying conduct, there is no such deterrent effect.⁵⁴ That is the precise flaw in the private class action system.

As I have already discussed, plaintiffs' attorneys have little incentive to choose cases based on the merits of the underlying claims—the merits question will virtually never be reached, as the empirical data demonstrates. The plaintiffs' lawyer's goal, rather, is to find a claim for which the complaint can withstand a motion to dismiss

⁵⁴ For an analogous discussion of how a failure to distinguish adequately between the culpable and the innocent dilutes the deterrent effect of sanctions in the criminal-law context, see A. Mitchell Polinsky & Steven Shavell, *The Theory of Public Enforcement of Law*, in 1 *Handbook of Law and Economics* 403, 427-29 (A. Mitchell Polinsky & Steven Shavell eds., 2007).

and that can satisfy the (legitimately) high hurdles for class certification—standards that do not embody an assessment of the underlying merit of the claim.

Because settlement inevitably follows once a class is certified, the class action’s burdens are not limited to businesses that engage in wrongful conduct. They are chiefly a function of whom plaintiffs’ lawyers choose to sue rather than who has engaged in actual wrongdoing. The threat of a class action therefore cannot—and does not—generally deter wrongful conduct.⁵⁵

Businesses are far more likely to be deterred from wrongdoing by the reputational consequences of engaging in improper behavior, especially because reputational harm is often directly correlated to a business’s success or failure. Especially in an age of social media, consumer complaints can quickly go viral, impacting companies immediately and directly leading to changes in practices that garner consumer opposition. Class actions, by contrast, do nothing of the sort.

The CFPB’s preliminary analysis of the costs and benefits of its proposed rule assumes that class actions both compensate injured consumers and deter wrongful conduct. It, therefore, counted 100% of projected settlement value as a “benefit” to consumers—but in reality there is no basis for that conclusion. The benefits provided by class actions, if any, are much more limited.

***Eliminating Arbitration to Protect Class Actions: Bad for Consumers,
Good for Lawyers***

Consumers deprived of arbitration would lose access to a means of securing justice that is cheaper and more accessible than court. The ability to vindicate wrongs that can’t practically be vindicated in court would disappear. And, those are the sorts of injuries that most consumers complain of. Few consumers are scouring disclosures or privacy policies to find technical violations of law that don’t impact their daily lives—that is what lawyers do.

Moreover, those individualized injuries are the types of harms that regulators don’t address because there is insufficient “impact” when regulatory resources are

⁵⁵ Indeed, to the extent there is any effect associated with class actions, it is likely to deter both lawful and unlawful actions equally—requiring companies to take into account the risk of litigation costs without regard to the legality of the underlying action.

focused on a small injury unique to a consumer, even when the injury is very significant in that consumer's life.

And, there is no reason to believe that consumers would be unable to use arbitration to pursue small claims. Justice Kagan, writing an opinion for herself and Justices Ginsburg and Breyer in *American Express Co. v. Italian Colors Restaurant*, expressly pointed to several ways in which even small claims can be vindicated in arbitration without the use of class action procedures:

In this case,...the [arbitration] agreement could have prohibited class arbitration without offending the effective vindication rule *if* it had provided an alternative mechanism to share, shift or reduce the necessary costs. The agreement's problem is that it bars not just class actions, but also all mechanisms...for joinder or consolidation of claims, informal coordination among individual claimants, or amelioration of arbitral expenses.⁵⁶

The arbitration provision that the Supreme Court viewed favorably in the *Concepcion* case contains both (i) incentive/bonus payments designed to encourage the pursuit of small claims, and (ii) the shifting of expert witness costs and attorneys' fees to defendants when the consumer or employee prevails on his or her claim. Specifically, if a consumer obtains an arbitral award that is greater than the company's last settlement offer, he or she will receive a minimum recovery of \$10,000 plus twice the amount of attorneys' fees that his or her counsel incurred for bringing the arbitration. In addition, the company is required to reimburse such a customer for reasonable expert witness fees.

Both of the lower courts in *Concepcion* found that the plaintiffs would be ***better off under arbitration than in a class action*** because they would be compensated more quickly and more completely.⁵⁷ As Justice Kagan explained in *American Express*, any concerns about whether individuals can vindicate their small claims in arbitration without the class-device are eliminated when an arbitration provision "provide[s] an alternative mechanism to.... shift...the necessary costs."⁵⁸ A significant number of companies have adopted similar provisions.

⁵⁶ *Am. Express Co. v. Italian Colors Rest.*, 133 S. Ct. 2304, 2318 (2013) (Kagan, J., dissenting)

⁵⁷ *Concepcion*, 131 S. Ct. at 1753.

⁵⁸ *Am. Express*, 133 S. Ct. at 2318 (Kagan, J., dissenting).

In addition, Justice Kagan stated that the concern about cost could be addressed through “*informal coordination among individual claimants*” to share the same lawyer, expert, and other elements required to prove the claim.⁵⁹ For example, an entrepreneurial plaintiffs’ lawyer can recruit large numbers of clients (via the internet, social media, or other similar means), file thousands of individual arbitration demands on behalf of those clients, and distribute common costs over all those claimants, making the costs for expert witnesses and fact development very low on a per-claimant basis.

Given the low cost, efficiency, and fairness of arbitration, it is no surprise that some plaintiffs’ lawyers are already beginning to recognize that pursuing multiple individual arbitrations (or small-claims actions) is an economically viable business model—especially in view of the ability to reach multiple, similarly situated individuals using websites and social media.⁶⁰ Indeed, this strategy for spreading fixed litigation costs is an increasingly common means of pursuing disputes in arbitration.

Most importantly, the Bureau was created for the very purpose of addressing conduct that causes widespread consumer harms—the same types of claims that can be brought as class actions. Its claim of a lack of enforcement resources rings hollow in light of broad enforcement authority, broad supervision authority, and guaranteed funding. There, simply, is no need to rely on self-interested class action lawyers given the obvious flaws of the class action system and the benefits to consumers from arbitration.

I appreciate the opportunity to appear before the Subcommittee and look forward to answering your questions.

⁵⁹ *Id.* (emphasis added). The dissent concluded that the American Express arbitration agreement prohibited such cost-sharing, but the majority disagreed, and American Express specifically conceded before the Supreme Court that costs could be shared in this manner. *See id.* at 2311 n.4 (majority).

⁶⁰ *See* Carolyn Whetzel & Jessie Kokrda Kamens, *Opt Out’s Use of Social Media Against Honda in Small Claims Win Possible “Game Changer,”* Bloomberg BNA Class Action Litig. Rep. (Feb. 10, 2012).

APPENDIX

Arbitration is an important means of resolving disputes that provides significant benefits to consumers and businesses. As the U.S. Chamber of Commerce Center for Capital Markets Competitiveness (“CCMC”) and the U.S. Chamber Institute for Legal Reform (“ILR”) explained in detail in comments to the CFPB,¹ arbitration of consumer disputes has been common practice for decades; there are perhaps hundreds of millions of consumer contracts currently in force that include arbitration agreements—many of them relating to consumer financial products or services.

The Bureau’s study is deeply flawed in numerous respects:

- It ignores the practical benefits of arbitration as compared to the court system for vindicating the types of injuries that consumers most often suffer (pp. 1-3, below);
- It greatly exaggerates the supposed benefits of class actions (pp. 3-8);
- It ignores the significant role of government enforcement—particularly the CFPB’s own enforcement and supervision processes—in protecting consumers (pp. 8-9).
- It fails to consider the benefits that arbitration provides to injured parties in a variety of contexts—including in consumer arbitrations, when consumers are not discouraged by plaintiffs’ lawyers and others from invoking arbitration (pp. 9-14); and
- It wrongly denies the reduced transaction costs resulting from arbitration, which produce lower prices for consumers (pp. 14-18).

A. *As the Bureau’s study of individual lawsuits confirms, for most injured consumers, the judicial system is not a realistic means for obtaining redress.*

Arbitration provides consumers, employees, and other injured parties with accessible and fair procedures for obtaining redress for claims that cannot be vindicated in court.

Many criticisms of arbitration are based on a flawed premise that the alternative system—litigation in court—gives individuals a meaningful and realistic option for resolving their disputes. That premise would make sense only if the judicial system were free of transaction costs, if every legitimate claimant could obtain legal representation, and if lawsuits were resolved expeditiously. But today’s judicial system falls far short of that ideal: litigation in court is costly and prone to intolerably long delays, and claimants often have difficulty finding a lawyer to take their case.²

¹ Letter from David Hirschmann & Lisa Rickard to Monica Jackson, *Re: Request for Information Regarding Scope, Methods, and Data Sources for Conducting Study of Pre-Dispute Arbitration Agreements*, Docket No. CFPB-2012-0017, Supplemental Submission (Dec. 11, 2013), available at http://www.instituteoflegalreform.com/uploads/sites/1/2013_12.11_CFPB_-_arbitration_cover_letter.pdf (“Chamber Comment II”); Letter from David Hirschmann & Lisa Rickard to Monica Jackson, *Re: Request for Information Regarding Scope, Methods, and Data Sources for Conducting Study of Pre-Dispute Arbitration Agreements*, Docket No. CFPB-2012-0017 (June 12, 2012), available at <http://www.regulations.gov/#!documentDetail;D=CFPB-2012-0017-0051> (“Chamber Comment I”).

² See *Chamber Comment II* at 6-9.

Most wrongs suffered by consumers are relatively small and individualized—excess charges on a bill, a defective piece of merchandise, and the like—and are simply too small to justify paying a lawyer to handle the matter. Such claims do not—and could not—attract lawyers willing to work on a contingency fee basis, because the claim promises no substantial recovery (and therefore no substantial legal fee).³ And because these claims are individualized, they do not share the common factual basis required for a class action to be certified.

Even when a claim is large enough to justify paying an attorney's fees—or to attract a contingency-fee lawyer—the complexity of the litigation system makes litigation costly and inconvenient. In addition, every participant in the legal system faces a significant access-to-justice problem in our overcrowded and underfunded courts: docket backlogs have skyrocketed, courthouses have been closed due to budget cuts, and trials are delayed. In California, for example, repeated budget cuts have forced 52 courthouses and 202 courtrooms to close, prompting the state judiciary to warn that funding for the state's courts is no longer “enough to sustain a healthy [judicial system].”⁴ Los Angeles County, the state's largest, reported this year that its remaining courts are facing “unmanageably high” workloads, which is producing “intolerable delay” in civil cases.⁵

As a result of these structural problems, it is extremely difficult, if not impossible, for individual consumers to litigate their claims in court as a practical matter. The Bureau's study results reflect this reality and demonstrate that litigation in court on an individual basis is not a realistic prospect for most people.

The Bureau examined individual (*i.e.*, non-class) cases brought in federal court by individual plaintiffs. Only in a minuscule percentage of the cases studied—5.6%—did plaintiffs pursue their claims *pro se*, confirming that litigation in court without the assistance of an attorney is infeasible for most consumers. The vast majority—90%—of federal-court individual cases the Bureau studied resulted in a known or potential settlement of the individual's claims. But the Bureau found very little data about the settlements; in the few cases where it did, the “amounts of the settlements ranged from \$250 to \$15,000.” Individual arbitration settlements and awards reflect similar or better successes: where data was available, “the average and median [debt] forbearance amounts were \$ 6,968 and \$4,900.”

Consumers obtained judgments in only 6.8% of the court cases studied, but most of those judgments involved a default judgment against the company. And for all the emphasis

³ One study reported that a claim must be worth at least \$60,000. Elizabeth Hill, *Due Process at Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 Ohio St. J. on Disp. Resol. 777, 783 (2003). In some markets, this threshold may be as high as \$200,000. Recommendations of the Minnesota Supreme Court Civil Justice Reform Task Force 10 (Nov. 23, 2011), <http://www.mnbar.org/sections/outstate-practice/11-23-11%20Civil%20Justice%20Reform.pdf>.

⁴ Judicial Council of Cal., *InFocus: Judicial Branch Budget Crisis*, available at <http://www.courts.ca.gov/partners/courtsbudget.htm>.

⁵ Judicial Council of Cal., *2015 Budget Snapshot: County of Los Angeles* (Feb. 2015), available at http://www.courts.ca.gov/partners/documents/County_Budget_Snapshot_Combined_2015.pdf.

that critics of arbitration place on the importance of a jury trial, only *one* judgment for a consumer “was the result of a trial.”⁶

The Bureau’s review of small claims courts—and “what use parties made of” these courts “with respect to consumer financial disputes”⁷—provides little reason to believe that consumers can effectively pursue relief in those forums, either. The Bureau undertook a limited examination of small claims court, cabining its review to “potential credit card cases involving a set of ten large credit card issuers.”⁸ It appears that the Bureau simply counted the number of consumer credit card disputes, and did not address other categories of disputes that consumers may have. The report does not make a qualitative assessment of how small claims court operates in practice.

In fact, while small-claims courts were developed to make it easier for individuals to proceed without representation, they do not provide a realistic alternative because those courts are overcrowded and underfunded—as numerous media investigations have demonstrated.⁹ For individuals unable to pursue their claims in arbitration, the outlook in small claims court is grim. The Bureau failed to assess the practical reality for these consumers.

B. *The Bureau’s study paints an unjustifiably positive and one-sided picture of class actions, which provide virtually no benefits to the vast majority of consumers.*

The principal attack on arbitration—strongly touted by the plaintiffs’ bar—stems from the fact that arbitration agreements typically require that arbitration proceed on an individual basis and bar class procedures in arbitration and in court. This argument rests on a dubious assumption: that the elimination of class actions deprives consumers of a procedural mechanism that supposedly provides enormous benefits by allowing the vindication of small claims that (according to the argument) would be too expensive for plaintiffs to arbitrate individually. The Bureau’s proposal rests entirely on this argument, claiming that consumers are “significantly better protected from harm” when they are able to bring class action lawsuits and that class actions must be preserved.

But even the Bureau’s own gerrymandered study does not support this idealized view of the class action system. Although the language of the study report is carefully crafted to avoid criticizing class actions, the study’s underlying data actually establish that class actions are, on the whole, not effective for the kinds of claims that most individuals are likely to have. These details—buried in the Bureau’s study among the more conspicuous statements implying

⁶ Consumer Fin. Protection Bureau, *Arbitration Study: Report to Congress, pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act § 1028(a)* at section 6, pages 48-49 (Mar. 1, 2015) (“CFPB Study”).

⁷ *Id.* at section 7, pages 2-3.

⁸ *Id.* at section 7, page 6.

⁹ *Chamber Comment II* at 9-13; see also William Glaberson, *Despite Cutbacks, Night Court’s Small Dramas Go On*, N.Y. TIMES, June 2, 2011, available at <http://www.nytimes.com/2011/06/03/nyregion/despite-cutbacks-new-york-small-claims-courts-trudge-on.html>; Emily Green, *Budget Woes Mean Big Delays For Small Claims Courts*, Nat. Pub. Radio, May 15, 2013, available at <http://www.npr.org/2013/05/17/182640434/budget-woes-mean-big-delays-for-small-claims-courts>.

that class actions are beneficial—in fact offer further proof that most class actions provide no benefit to consumers.

First, most cases filed as purported class actions are not resolved in a manner that provides any benefit to absent class members. According to the Bureau's data, 87% of resolved class actions (excluding claims affected by arbitration agreements) resulted in no benefit to absent class members. Instead, most were dismissed by or settled with the named plaintiff only. The Bureau found that only 12% of putative class actions were finally approved for classwide settlement during the study period.¹⁰

That is an even smaller than the proportion observed in another study conducted in 2013 by Mayer Brown LLP on behalf of the Chamber of Commerce.¹¹ That study found that *the overwhelming majority of class actions result in no recovery at all* for members of the putative class. Approximately two-thirds of cases studied were dismissed on the merits by the court, or dismissed voluntarily by the plaintiff.

The Bureau's report fails to acknowledge it, but the plain fact is that absent class members receive nothing unless a class action is settled on a class-wide basis, or there is a class-wide judgment for plaintiffs (something that almost never happens).

Second, even in those cases that do result in class settlements, most class members still receive nothing. The Bureau's report attempts to tout the purportedly large number of class members "eligible for relief," but the only relevant metric is the rates at which "eligible" class members actually received relief, typically after submitting claims. In sharp contrast with the flood of statistics provided on other topics—including the numbers of class members eligible for relief when cases settle—the Bureau's report seemed designed to obscure the proportion of eligible class members who actually submitted claims. Where statistics were available, the Bureau's study reported a "weighted average claims rate" of just 4%.¹² That comports with the Chamber's study, which found that (in the handful of cases where statistics were available, and excluding one outlier case involving individual claims worth, on average, over \$2.5 million) the claims rates were miniscule: 0.000006%, 0.33%, 1.5%, 9.66%, and 12%.¹³

The Bureau's own study thus shows that even in the 13% of class actions that did settle on a classwide basis, approximately 96% of class members received no benefit. The Bureau could have—and should have—provided a precise calculation of the overall likelihood that a class member will receive a benefit in a class action, but even a back-of-the-envelope estimate suggests that claims-made settlements provide very little to the broader set of individuals on whose behalf plaintiffs seek to bring class actions. If an average of 4 percent of class members (weighted by size of the class) made claims in settlements and only 13 percent of class actions result in settlements to begin with, then only a very, very tiny percentage of the members of potential classes ever receive any recovery.

¹⁰ *Id.* at section 6, page 37.

¹¹ Mayer Brown LLP, *Do Class Actions Benefit Class Members? An Empirical Analysis of Class Actions* (Dec. 11, 2013) ("*Chamber Study*"), available at <http://www.mayerbrown.com/files/uploads/Documents/PDFs/2013/December/DoClassActionsBenefitClassMembers.pdf>.

¹² *Id.* at section 8, page 30.

¹³ *Chamber Study* at 7 & n.20.

Why do the low claims rates in most class actions matter? In determining who benefits, it makes no difference how many people are “eligible” to make claims; all that matters is who follows through and actually receives compensation. As the Chamber’s study explained, there are many reasons why a class member might not submit a claim, such as because he or she believes the modest award is not worth their while, or the process is burdensome, or they do not believe they have been injured in the first place.¹⁴ But whatever their reasons, it is clear that most class members do not submit claims and thus are not made better off by class actions.

The Bureau’s study also reveals other data about how class actions provide little value to individuals (although, again, one has to dig beneath the surface). For example, the study carefully avoids any mention of the *average* amount of payments to class members, instead trumpeting “a total of \$1.1 billion in 251 settlements.” It elsewhere says that 236 settlements involved 34 million class members “who received, or will receive, a cash payment.” Even if one gives the Bureau the benefit of the doubt and assumes that the extra 15 cases included in the first total and not in the second had *no* class members, the average settlement payment in these 251 settlements was \$32.35.¹⁵

What is more, claimants had to wait significantly longer in class actions than in arbitration to obtain relief. According to the Bureau, class actions that settled on a classwide basis—and for which it was thus even *possible* that a class action could provide benefits to absent class members—took an average of two years to resolve. (The Chamber’s class action study found that some class actions take even longer; 14% of the class actions that the Chamber examined were still pending *four years* after they were filed, with no end in sight).¹⁶ The two-year average duration calculated by the Bureau, moreover, may not even include the time needed for consumers to submit claims and receive payment *after* a settlement is reached. In contrast to the interminable length of most class actions, meanwhile, arbitrations resolved by an arbitrator took between four and eight months to resolve, and those arbitrations that were settled took a mere two to five months.¹⁷

In sum, the Bureau’s own data reveal that class members in the vast majority of class actions receive no more than a pittance—and then only after a long wait while the lawsuit drags on.

Third, the Bureau’s data also shows that while class members receive little, *the lawyers who bring these class actions do very well for themselves*. Based on the Bureau’s report, the average fee paid to plaintiffs’ lawyers—as a percentage of the announced settlement (not the smaller amount actually distributed to class members)—was 41%, with a median of 46%. The total attorneys’ fees in the cases studied by the Bureau added up to \$424 million for 419 cases, which works out to an average of *more than \$1 million per case*.¹⁸ It is telling that the Bureau did not attempt to compare this staggering amount paid to by plaintiffs’ lawyers with the meager amount that class members *actually* received.

¹⁴ *Id.*

¹⁵ CFPB Study at section 8, pages 27-28.

¹⁶ Chamber Study at 1.

¹⁷ *Id.* at section 5, page 72; *id.* at section 8, page 37.

¹⁸ *Id.* at section 8, page 33.

These massive attorneys' fees are but one part of the equation: They do not include the other very large transaction costs associated with litigating class actions—the defense costs that companies must pay in all cases, and the cost to the courts of handling these cases. *The Bureau does not even attempt to determine whether the class action system justifies these enormous costs.*

Perhaps the Bureau chose not to try to answer that question because it knew it would not like the answer: our class action system is *not* worth its high costs, because it produces only paltry benefits to consumers. Again, the Bureau found that the average settlement payment in a class action is just \$32. And in many class actions, class members receive far less. Indeed, some class actions result in settlements where class members receive only small coupons; in these coupon cases, as one commentator puts it, “[t]he lawyers ha[ve] a nice payday and most of the class members pitch[] the coupons into the trash.”¹⁹ Professor Martin Redish has decried this phenomenon of “faux class actions,” in which “as a practical matter [class members] will receive no damages” and “[t]he real parties in interest” are “the plaintiffs’ lawyers, who are the ones primarily responsible for bringing th[e] proceeding.”²⁰

In some class actions, moreover, plaintiffs receive *literally nothing at all*, because the only relief awarded in the settlement is injunctive relief or *cy pres* relief, which requires the defendant to pay money to a charitable organization. Chief Justice John Roberts has raised concerns about the “fairness” of *cy pres* settlements,²¹ and scholars have suggested that they violate absent class members’ due process rights.²² But despite the fact that injunctive and *cy pres* relief do almost nothing to benefit class members, plaintiffs’ attorneys eagerly pursue both, because “class counsel’s interest in maximizing its fees is satisfied regardless of whether the settlement funds are paid to class members or distributed *cy pres*.”²³

Fourth, contrary to the Bureau’s assertions, our abusive and wasteful class action system is not necessary to allow consumers with small claims to vindicate their rights effectively. Indeed, in the Supreme Court’s recent decision in *American Express Co. v. Italian Colors Restaurant*, both the majority and the dissent rejected that notion. The dissent, written by Justice Kagan and joined by Justices Ginsburg and Breyer, identified several different ways in which consumers could effectively vindicate even small claims in arbitration without the use of class action procedures:

In this case, . . . the [arbitration] agreement could have prohibited class arbitration without offending the effective vindication rule *if* it had provided an

¹⁹ Rob Berger, *The CFPB Declares War on Arbitration*, Forbes, Oct. 18, 2015, available at <http://www.forbes.com/sites/robertberger/2015/10/18/the-cfpb-declares-war-on-arbitration>.

²⁰ Testimony of Martin H. Redish at 7, U.S. House of Representatives, Committee on the Judiciary, Subcommittee on the Constitution, *Hearing: Class Actions Seven Years After the Class Action Fairness Act* (June 1, 2012), available at http://judiciary.house.gov/_files/hearings/Hearings%202012/Redish%2006012012.pdf.

²¹ See *Marek v. Lane*, 134 S. Ct. 8, 9 (2013) (Roberts, C.J., respecting the denial of certiorari) (noting the many “fundamental concerns surrounding the use of [*cy pres*] remedies in class action litigation”).

²² Martin H. Redish et al., *Cy Pres Relief and the Pathologies of the Modern Class Action*, 62 Fla. L. Rev. 617, 650 (2010).

²³ Rhonda Wasserman, *Cy Pres in Class Action Settlements*, 88 S. Cal. L. Rev. 97, 123 (2014).

alternative mechanism to share, shift or reduce the necessary costs. The agreement's problem is that it bars not just class actions, but also all mechanisms . . . for joinder or consolidation of claims, informal coordination among individual claimants, or amelioration of arbitral expenses.²⁴

Consumers increasingly have access to arbitration systems that provide all of the features that the *Italian Colors* dissent identified as necessary to allow for effective, individual vindication of small claims. For example, many companies now have arbitration agreements that "shift" the "costs" of arbitration to the company and provide bonus and incentive payments to consumers who prevail.²⁵ It is also easier than ever before for individual claimants to coordinate their claims by sharing the same lawyer, expert, and other elements required to prove a claim. For example, an entrepreneurial plaintiffs' lawyer can recruit large numbers of clients (via the internet, social media, or other similar means), file thousands of individual arbitration demands on behalf of those clients, and distribute common costs over all those claimants, making the costs for expert witnesses and fact development negligible on a per-claimant basis.

There are thus multiple alternatives to private class action lawsuits in court brought by entrepreneurial plaintiffs' attorneys; these alternatives afford individual consumers and employees actual opportunities to pursue their disputes or otherwise vindicate their rights—in sharp contrast to the false promise of private class actions.

Fifth, in an attempt to sidestep the facts that class actions often provide no benefit to class members and are unnecessary to vindicate small consumer claims, the Bureau contends in its October 2015 rulemaking announcement that class actions also serve the broader social purpose of deterring wrongdoing. By threatening companies that violate the law with huge liability, the Bureau claims, class actions "strengthen[] incentives for [companies] to engage in robust compliance."²⁶ But this deterrence argument doesn't hold water.

In order for class actions to deter wrongdoing, parties must fear that they will be subject to class action liability if they act wrongfully. But plaintiffs' lawyers don't choose which class actions to bring based on the merits of the underlying claims; rather, they simply look for *any* claims that can withstand a motion to dismiss and satisfy the standards for class certification. These lawyers know that, as Justice Ruth Bader Ginsburg has observed, once a class is certified, the "potentially ruinous liability" facing a defendant "places pressure on the defendant to settle even unmeritorious claims."²⁷ In any case where class certification is granted, the rational thing for a defendant to do is settle rather than risk going to trial, even if it has done nothing wrong; as one appellate judge has put it, class certification "is, in effect, the whole case."²⁸ The Bureau's

²⁴ *Am. Express Co. v. Italian Colors Rest.*, 133 S. Ct. 2304, 2318 (2013) (Kagan, J., dissenting).

²⁵ See *Chamber Comment II* at 31-36 (collecting arbitration agreements).

²⁶ CFPB Proposal at 15.

²⁷ *Shady Grove Orthopedic Assocs., P.A. v. Allstate Ins. Co.*, 130 S. Ct. 1431, 1465 n.3 (Ginsburg, J., dissenting) (internal quotation marks omitted).

²⁸ Hon. Diane Wood, Circuit Judge, Remarks at the FTC Workshop: Protecting Consumer Interests in Class Actions (Sept. 13-14, 2004), in *Panel 2: Tools for Ensuring that Settlements are "Fair, Reasonable, and Adequate"*, 18 Geo. J. Legal Ethics 1197, 1213 (2005).

own findings back up this analysis: the Bureau found that classwide judgments for plaintiffs on the merits after a trial are virtually unheard of, occurring in “less than 1% of cases.”²⁹

Because the threat of class action liability is a function of who plaintiffs’ lawyers sue, rather than of whether a business who has engaged in actual wrongdoing, class actions cannot—and do not—generally deter wrongful conduct. On the contrary, even law-abiding businesses must treat class actions as an inevitable cost of doing business.

Businesses are far more likely to be deterred from wrongdoing by the reputational consequences of engaging in improper behavior, because reputational harm is often directly correlated to a business’s success or failure. In the age of social media, consumer complaints can quickly go viral on Facebook, Twitter, and change.org (to name a few examples). That phenomenon impacts companies immediately and directly leads to changes in practices that garner consumer opposition. Class actions, by contrast, rarely, if ever, have that effect.

C. Government enforcement plays a significant role in protecting consumers.

Companies are likely, however, to be deterred by the threat of government enforcement action. That is especially the case in light of the enhanced government enforcement capabilities in the consumer financial protection space. Not only are the monetary penalties higher, but an enforcement action brought by the government reflects the government’s judgment that its limited resources should be used to combat what it considers improper activity.³⁰

Of course, not all government enforcement actions are brought against covered persons who have actually engaged in wrongdoing. But while companies view class actions as a cost of doing business—rent seeking by any one of a large number of entrepreneurial plaintiffs’ lawyers who are banking on the possibility that they may be able to coerce a settlement—companies are far more likely to take notice of a government enforcement action. For that reason, government enforcement plays a significant role in protecting consumers. That role is likely to increase substantially given the Bureau’s supervision and enforcement authority.

The Bureau’s study provides zero support for class action proponents’ common claim that class actions play an important role in supplementing government enforcement efforts. The Bureau found, for example, that most government enforcement is independent of private lawsuits. Less than 9% of government enforcement actions were preceded by a private class action.³¹

For cases in which there was no government enforcement action (6%), the study does not indicate how much consumers actually received under class action settlements. (It only provides “gross” numbers.) It is therefore impossible to determine whether these settlements actually provided meaningful consumer benefits. It is also impossible to determine what amount of these settlements companies actually paid out – the amount that would be relevant if, contrary to the evidence, companies were deterred by the prospect of settling class actions brought by entrepreneurial plaintiffs’ lawyers.

²⁹ CFPB Study at section 6, page 37.

³⁰ *Id.* at section 9, page 12.

³¹ *Id.* at section 9, page 14.

Most importantly, the study period ended in 2012, and therefore *entirely fails to take account of the effect of the Bureau's own fully functioning enforcement and supervision programs*. In the year ending December 31, 2012, the Bureau was a party to 9 enforcement actions.³² In the year ending September 30, 2014, there were 41 public enforcement actions.³³ And the Bureau has used its supervisory authority to conduct hundreds of examinations.³⁴ The Bureau also provides a forum in which consumers can file complaints against financial institutions; it reports that financial institutions have already responded to *more than 450,000 of these complaints, with 98% of consumers receiving a timely response*.³⁵

The entire reason for creating the Bureau was to increase enforcement of consumer laws: the Bureau's existence, combined with the numerous other state, local, and federal enforcement agencies, underscores that class actions have little, if any, role to play in this context—unless the Bureau does not believe that its significant resources and authority will provide consumers with additional protection.

Moreover, the Bureau is likely to focus on the precise types of wrongdoing that are susceptible to class actions: misconduct that affects a large number of consumers. And the Bureau's examination authority, combined with its enforcement activities and consumer complaint database, make it highly likely that the Bureau will detect such wrongdoing. The Bureau's enforcement powers therefore provide an additional, significant factor why the threat of class actions is irrelevant to deterring wrongful conduct in this context.

D. *The Bureau's study does little to evaluate—or even describe—the procedures available in arbitration that afford consumers with fair, faster, and less expensive dispute resolution compared with litigation.*

The Bureau's own study reveals that—especially in contrast to class action litigation—arbitration provides consumers with effective procedures that enable them to obtain relief on claims that would be impractical to pursue in court.

The reasons that consumers cannot pursue most of their potential claims in court are (1) the claims are too small to attract a lawyer (typically more than \$50,000 must be at issue in order to do so), and (2) the claims are too individualized to be addressed in a class action.

³² *Semi-Annual Report of the CFPB*, March 2013, at 66, available at http://files.consumerfinance.gov/f/201303_CFPB_SemiAnnualReport_March2013.pdf.

³³ *Semi-Annual Report of the CFPB*, Fall 2014, at 103, available at http://files.consumerfinance.gov/f/201412_cfpb_semi-annual-report-fall-2014.pdf.

³⁴ *CFPB Supervisory Highlights*, Spring 2014, at 5, available at http://files.consumerfinance.gov/f/201405_cfpb_supervisory-highlights-spring-2014.pdf (“In 2013, the CFPB conducted over one hundred supervisory activities—such as full scope reviews and subsequent follow-up examinations—and plans to conduct approximately 150 of these activities in 2014.”).

³⁵ Berger, *supra* note 19.

Consumers who use arbitration get decisions on the merits more frequently and more quickly than they would in court. Consumers win at least as often, if not more often, than they do in court.³⁶ And companies pay most of the fees associated with arbitration.³⁷

The Bureau made no serious effort to examine the benefits of arbitration because it did not make any qualitative effort to assess how arbitration's procedures work and whether those procedures would facilitate the ability of consumers to bring claims.

But even the narrow examination of arbitration that the Bureau *did* undertake confirms arbitration's advantages:

- *More of consumers' affirmative claims were decided on the merits:* 24% in arbitrations, compared to less than 8% in litigation (and all but three of those were default judgments).³⁸ The success rate for consumers was even higher—27.2%—in the subset of arbitrations where the consumer brought affirmative claims but did not dispute any alleged debts.³⁹
- In arbitrations resolved by arbitrators involving affirmative claims by consumers where data on the amount of the award was available, consumers received relief on 32 claims on the merits; the average payment to consumers was \$5,389, and the median amount was \$2,682.⁴⁰ Those awards are *significantly greater than the relief to claimants in class action settlements*.
- The one reported court award was \$4,925; the average settlement was \$2,128; and the median amount was \$1,001. Those consumers who were able to use arbitration to obtain a merits decision did much better.
- *Consumers did better without a lawyer than with one:* as two prominent scholars at George Mason University explain in a critique of the Bureau's study, the Bureau's data showed that "self-represented plaintiffs were seven times more likely than represented plaintiffs to get an AAA arbitrator's decision in their favor." That finding, they conclude,

³⁶ Compare Christopher R. Drahozal & Samantha Zyontz, *An Empirical Study of AAA Consumer Arbitrations*, 25 Ohio St. J. on Disp. Resol. 843, 898 (2010) (studying claims filed with the American Arbitration Association and concluding that consumers win relief 53.3% of the time), with Theodore Eisenberg et al., *Litigation Outcomes in State and Federal Courts: A Statistical Portrait*, 19 Seattle U. L. Rev. 433, 437 (1996) (observing that in 1991-92, plaintiffs won 51% of jury trials in state court and 56% of jury trials in federal court, while in 1979-1993 plaintiffs won 50% of jury trials).

³⁷ Elizabeth Hill, *Due Process at Low Cost: An Empirical Study of Employment Arbitration Under the Auspices of the American Arbitration Association*, 18 Ohio St. J. on Disp. Resol. 777, 802 (2003) (finding that lower-income employees "paid no forum fees" in 61% of the cases studied; employees also paid no attorney's fees in 32% of the cases).

³⁸ See *id.* at section 6, pages 48-49.

³⁹ *Id.* at section 5, page 39.

⁴⁰ *Id.* at section 5, page 41.

suggests that in arbitration, “hiring an attorney offers little value to a consumer and is often unnecessary.”⁴¹

To the extent the Bureau does discuss the terms of arbitration agreements, it presents a false and misleading picture of the arbitral process.

The Bureau recites various provisions of certain arbitration agreements—for example, provisions that bar punitive or consequential damages, limit the time period for filing claims, or require hearings in particular locations, or permit a company to recover attorneys’ fees whenever it prevails.⁴² But the Bureau fails to explain that courts have routinely and consistently invalidated such provisions on state-law unconscionability grounds—a point that the Chamber has made fully clear to the Bureau.⁴³ That omission is an obvious attempt by the Bureau to create the patently erroneous impression that such provisions are being applied in practice simply because they are included in the terms of some arbitration agreements.

Even more troubling, the Bureau simply failed even to mention—much less analyze—the extent to which arbitration creates incentives for companies to settle individual claims or disputes even before the filing of a formal arbitration proceeding. Because businesses subsidize most or all of the costs of arbitration—under AAA consumer rules, for example, a business must cover at least \$1500 in filing fees⁴⁴—it is economically rational for every business that is subject to an arbitration provision to settle disputes of less than \$2,000-5,000 before an arbitration is commenced. That incentive is lacking in court, where the cost burden falls on the consumer.

In addition, many arbitration agreements create significant incentives to settle claims before arbitration begins, such as through arbitration provisions that—like the provision at issue in *AT&T Mobility v. Concepcion*—contain potential bonus payments to customers who do better in arbitration than a company’s last settlement offer (providing, for example, that the customer will be awarded a minimum amount, often \$5,000-10,000, plus attorneys’ fees and, often, other costs). It is thus a straightforward matter of economics that, if a consumer has a dispute with a company of less than the bonus figure—and the claim is not frivolous or abusive—the company has every reason to settle by offering a payment (often for the full amount of the claim plus an amount for attorneys’ fees) that satisfies the customer.

The Supreme Court explained in *Concepcion* that the consumers’ claim in that case was “most unlikely to go unresolved” because the arbitration provision at issue provided that the company would pay the Concepcions a minimum of \$7,500 and twice their attorneys fees if they obtained an award “greater than AT&T’s last settlement offer.”⁴⁵ And this self-imposed incentive to settle occurs not just at the stages of a formally commenced arbitration or the pre-

⁴¹ Jason Scott Johnston & Todd Zywicki, *The Consumer Financial Protection Bureau’s Arbitration Study: A Summary and Critique* 26 (Mercatus Ctr., George Mason Univ., Working Paper, Aug. 2015), available at http://www.law.gmu.edu/assets/files/publications/working_papers/LS1507.pdf.

⁴² *Id.* at section 2, pages 45-64.

⁴³ *Chamber Comment II* at 23-28.

⁴⁴ AAA Consumer Arbitration Rules at 34, available at <https://www.adr.org/aaa/ShowProperty?nodeId=/UCM/ADRSTAGE2021425&>.

⁴⁵ *AT&T Mobility v. Concepcion*, 131 S. Ct. 1740, 1753 (2011).

arbitration negotiation period. Instead, large numbers of AT&T customers have their concerns resolved at a much earlier point by calling or e-mailing AT&T's customer care department, which is remarkably effective: the record in *Concepcion* indicated that AT&T representatives awarded more than \$1.3 billion in compensation to customers during a single twelve-month period in response to customer concerns and complaints.

The Supreme Court, and other courts, have found that provisions like these give companies a very significant incentive to settle even marginally meritorious claims on terms favorable to claimants—in order to avoid the downside risk of losing and having to pay the bonus amount.⁴⁶ That confers an important benefit not available in litigation, and one that cannot be quantified by looking at the results of arbitration proceedings. But the Bureau failed to examine the issue.

The Bureau also failed to examine how a well-functioning arbitration system works in practice. For example, the Bureau could have—but did not—study the arbitration system for the Kaiser Foundation Health Plan in California, which has more than seven million members. The Kaiser arbitration system gets high marks from health plan members, who have been involved in arbitration proceedings, most of them over medical malpractice claims. According to a 2013 survey conducted by Kaiser's independent arbitration administrator, almost 50% of the parties and attorneys who went through arbitrations that year reported that the arbitration system was better than going to court, another 38% reported that it was the same as going to court—and only 14% reported it was worse.⁴⁷ It also could have studied the use of arbitration in the securities industry.⁴⁸ *It did neither.*

The CFPB's December 2013 preliminary results of its arbitration study—attached as the Appendix A to the CFPB's report—suggest that few individuals bring small dollar claims in arbitration.⁴⁹ But for several reasons, the number of formal claims filed by consumers in arbitration and in court says nothing about the accessibility and fairness of the two methods of dispute resolution.

First, consumers' claims are often resolved before the filing of a formal arbitration proceeding. Individuals who file arbitration demands—just like those who file small claims court cases or lawsuits in court—are almost always a very small group of consumers whose

⁴⁶ See *id.*; see also *Coneff v. AT&T Corp.*, 673 F.3d 1155, 1159 (9th Cir. 2012) (noting that 'the *Concepcion* Court [had] examined this very arbitration agreement' and concluded 'that aggrieved customers who filed claims would be essentially guaranteed to be made whole' because "the arbitration agreement [at issue] has a number of fee-shifting and otherwise pro-consumer provisions") (quoting *Cruz v. Cingular Wireless*, 648 F.3d 1205, 1215 (11th Cir. 2011) (citing *Concepcion*, 131 S. Ct. at 1753)).

⁴⁷ *Annual Report of the Office of the Independent Administrator of the Kaiser Foundation Health Plan, Inc. Mandatory Arbitration System for Disputes with Health Plan Members, January 1, 2014 – December 31, 2014* at 44, available at <http://www.oia-kaiserarb.com/pdfs/2014-Annual-Report.pdf>.

⁴⁸ Fin. Indus. Regulatory Auth., *Dispute Resolution Statistics* (April 2015), available at <https://www.finra.org/arbitration-and-mediation/dispute-resolution-statistics> (noting that customer was awarded damages in 39 to 47 percent of customer claimant cases decided in arbitration over last five years, and that in 2013 "approximately 77 percent of customer claimant [arbitration] cases resulted, through settlements or awards, in monetary or non-monetary recovery for the investor").

⁴⁹ CFPB Study at Appendix A, pages 76-82.

concerns were not resolved through less-formal customer service mechanisms. When companies have millions of customers, it is likely that thousands—perhaps tens of thousands—of customers will at some point in their relationship have concerns that may or may not develop into full-fledged disputes. But the vast majority of those customer concerns are resolved through informal channels, such as customer service processes, negotiation, or mediation, before a concern ripens into a dispute and a formal arbitration demand is filed. As the George Mason professors explain in their critique of the Bureau’s study, it is good business for a company to resolve as many consumer disputes as possible informally: when consumers are dissatisfied, they can and do “take their . . . business elsewhere.”⁵⁰

Indeed, the George Mason scholars found that at one bank they examined, consumers who sought voluntary refunds from the bank successfully obtained them 68% of the time.⁵¹ Thus, they concluded, it may well be that “the overwhelming number of meritorious complaints” against businesses are “resolved consensually rather than by conflict” and that “those denied a refund do not arbitrate [because] their complaints lack merit.”⁵²

Even when internal dispute resolution mechanisms fail and consumers do file for arbitration, there are significant incentives for businesses to settle claims before arbitration begins. As explained above (at pages 11-12), businesses subsidize most or all of the costs of arbitration, and many have adopted arbitration agreements that provide for potential bonus payments to customers who do better in arbitration than a company’s last settlement offer. Significantly, a great many arbitration provisions require the company involved to pay all or nearly all of the arbitration costs, and many of the provisions include bonus provisions. Those agreements provide a very powerful incentive for pre-arbitration settlement of any non-frivolous consumer claim of \$5,000 or less.

Second, a concerted campaign to invalidate arbitration agreements was underway for the period studied by the Bureau. Plaintiffs’ lawyers vigorously resisted arbitration (with success in certain “magnet” jurisdictions for class actions) before *Concepcion*. And after the Supreme Court held in *Concepcion* that class waivers in arbitration agreements are enforceable, the plaintiffs’ bar has continued to search for ways to avoid their clients’ agreements to resolve their disputes in arbitration. The unfortunate effect of these widespread efforts is that lawyers who represent consumers and their allies in consumer advocacy organizations have discouraged consumers from pursuing their disputes in simplified, often cost-free arbitration.

Third, the Bureau examined the records of just one arbitration provider, the American Arbitration Association (AAA), ignoring the other arbitral forums open to consumers. In particular, consumers are increasingly using online dispute resolution providers to handle their small claims: one such online company, Modria, handles more than *60 million disputes per year*.⁵³ By focusing solely on the AAA, the Bureau failed to capture a significant portion of the arbitrations that happen today.

⁵⁰ Johnston & Zywicki, *supra* note 41, at 30.

⁵¹ *Id.* at 38.

⁵² *Id.*

⁵³ See <http://www.regulations.gov/#!documentDetail;D=CFPB-2012-0017-0019> (Modria comment submitted to CFPB June 19, 2012).

Finally, the focus on “small-value” claims presents a misleading picture of arbitration. The Bureau arbitrarily reported the incidence of claims involving \$1,000 or less and then concludes that few consumers arbitrate small claims.⁵⁴ But that definition is odd, given that—based on information compiled by the CFPB’s own December 2013 preliminary results—most state small-claims courts permit the assertion of claims of up to \$10,000.⁵⁵

Hopefully, the Bureau did not adopt this overly narrow definition in order to be able to assert, erroneously, that consumers do not use arbitration for small claims. In addition, of course, this analysis ignores entirely the fact, discussed above, that the terms of a growing number of arbitration agreements provide a very substantial incentive for the pre-arbitration settlement of such claims.

In sum, the Bureau’s examination of how arbitration works is patently inadequate, and will undermine the validity of any regulations that the Bureau might attempt to promulgate.

E. *The Bureau’s survey of consumers reveals only that consumers do not focus on dispute resolution when choosing among consumer financial products and services.*

The Bureau’s study touts the results of a telephonic survey in asserting that consumers are uninformed about the dispute resolution terms of their credit card agreements. But that survey is completely irrelevant to determining whether regulation of arbitration is “in the public interest and for the protection of consumers.”⁵⁶

That is because the Bureau refused to obtain information about consumers’ baseline level of knowledge of other key provisions of their card agreements.⁵⁷ Without that comparative baseline, the Bureau cannot determine whether consumers pay greater, less, or the

⁵⁴ CFPB Study at Appendix A, page 14.

⁵⁵ *Id.* at Appendix A, pages 160-61.

⁵⁶ The Bureau also cites a paper describing a web survey that was authored by Professor Jeff Sovern of St. Johns’ Law School (among others). But the Bureau’s discussion of that study fails to disclose (as Professor Sovern does) that the study was paid for from a grant by the American Association of Justice—*i.e.*, the trial lawyers who benefit from class action attorneys’ fee awards and therefore are invested in maintaining the class action system. Moreover, Sovern’s web survey also fails to ask participants about any contract provision *other* than the arbitration clause. It is telling (and quite unfortunate) that the Bureau’s survey suffers from the same problem that the trial-lawyer-funded Sovern study does. See CFPB Study at section 3, pages 7-8 (citing Jeff Sovern, Elayne E. Greenberg, Paul F. Kirgis, and Yuxiang Liu, “Whimsy Little Contracts” With Unexpected Consequences: An Empirical Analysis of Respondent Understanding of Arbitration Agreements (Oct. 29, 2014), available at <http://ssrn.com/abstract=2516432>).

⁵⁷ The Chamber repeatedly urged the Bureau to obtain such information, but the Bureau refused to do so. See Letter from David Hirschmann & Lisa Rickard, Re: “Telephone Survey Exploring Consumer Awareness of and Perceptions Regarding Dispute Resolution Provisions in Credit Card Agreements,” Docket No. CFPB-2013-0016 (June 30, 2014), available at <http://www.regulations.gov/#!documentDetail;D=CFPB-2014-0011-0015>; Letter from David Hirschmann & Lisa Rickard to Matthew Burton & PRA Office, Re: “Telephone Survey Exploring Consumer Awareness of and Perceptions Regarding Dispute Resolution Provisions in Credit Card Agreements,” Docket No. CFPB-2013-0016 (Aug. 6, 2013), <http://www.regulations.gov/#!documentDetail;D=CFPB-2013-0016-0015>.

same attention to dispute resolution clauses as to other clauses important to them—and why that might be so. As a result, the Bureau was not able to place information regarding dispute resolution systems in context—and thereby derive information that might be relevant to assessing consumers’ relative awareness of arbitration agreements versus other credit card contract provisions. The Bureau’s failure to elicit such information renders the survey data meaningless.

Indeed, the approach taken by the Bureau in constructing the survey unfortunately suggests that the Bureau’s analysis is results-oriented. Any neutral evaluation of credit card agreements would have not just inquired about dispute resolution provisions but also about other provisions as comparators (such as whether consumers recalled the interest rate or credit limit). Why didn’t the Bureau ask such a basic question? In the absence of an explanation from the Bureau, observers are left to conclude that obtaining such information would not serve the Bureau’s pre-ordained goals. If consumers do recall their interest rates and credit limits, that result would confirm that dispute resolution is not as salient as other terms (like the price of credit); and if they did not, that response would indicate that consumers simply don’t recall any of the elements of the credit card deal once they have entered into it, even those that are undoubtedly important to their decision. Either way, the irrelevance of the Bureau’s survey approach would have been confirmed.

The only data that the Bureau’s study delivers is that, unsurprisingly, consumers are not focused on arbitration clauses: *Not one consumer* (of 1,007 who completed the survey) volunteered dispute resolution procedures as a feature relevant to selection of their credit card. Even when asked to respond to each of a list of nine elements, dispute resolution was the least-selected choice.

That finding is entirely unsurprising. As we have seen, businesses have a strong incentive to resolve consumer disputes internally in order to keep consumers’ business. Thus, as the George Mason scholars explain, “consumers prefer the market to [a] legal response for perceived service failures”; if they do not get satisfaction from a company, they simply take their business elsewhere. And “[g]iven the effectiveness of this market response, consumers do not *need* to know anything about” whether their agreement with a company provides for arbitration or litigation.⁵⁸

F. *Arbitration clauses lead to lower prices for consumers.*

It cannot be debated that litigation in court—especially class-action litigation—imposes substantial transaction costs on businesses. Because arbitration offers a less-expensive forum for the resolution of disputes, it should reduce the transaction costs that businesses bear in the judicial system, and basic economic principles teach that some portion of those cost savings will be passed along to consumers.⁵⁹

Here’s how Professor Stephen Ware explains this phenomenon:

⁵⁸ Johnston & Zywicki, *supra* note 41, at 30, 32.

⁵⁹ See *Chamber Comment II* at 37-38, 54-55.

- “The consensus view is that businesses using adhesive arbitration agreements do so because those businesses generally find that those agreements lower their dispute resolution costs.”
- “In the case of consumer arbitration agreements, this benefit to businesses is also a benefit to consumers. That is because whatever lowers costs to businesses tends over time to lower prices to consumers.”
- “The extent to which cost-savings are passed on to consumers is determined by the elasticity of supply and demand in the relevant markets. Therefore, the size of the price reduction caused by enforcement of consumer arbitration agreements will vary, as will the time it takes to occur.”
- “But it is inconsistent with basic economics to question the existence of the price reduction.”⁶⁰

The Bureau’s analysis of whether consumers experience cost savings from arbitration is “inconsistent with basic economics,” because it claims that cost savings are absent.

The report does include caveats that would allow a careful reader to understand that, in fact, the Bureau’s analysis is of little value. Unfortunately, the Bureau failed to highlight those cautions. That said, the Bureau acknowledges that:

- “[t]he assertion that pre-dispute arbitration clauses generate cost savings, in itself, is difficult to test and has not been established or disproved”;
- “[w]hether such savings, to the extent they exist, are passed along to consumers is even more difficult to establish or disprove”;
- “[i]mportantly, even a correlation between the use of pre-dispute arbitration clauses and price levels should not be construed as a casual relationship between the two, absent additional information.”⁶¹

Despite these acknowledgments—which should have caused the Bureau to undertake a robust analysis rather than a rushed one—the Bureau proceeded to focus on the implications of one particular lawsuit (*Ross v. Bank of America*) in which some settling credit card issuers agreed not to use arbitration for a 3-½ year period.⁶² The question the Bureau asked is “whether it can find statistically significant evidence, at standard confidence level (95%), that companies that eliminated arbitration raised their prices (measured by total cost of credit) in a manner that was different from that of comparable companies that had not changed their policies regarding arbitration provisions.”⁶³

⁶⁰ Stephen J. Ware, The Case for Enforcing Adhesive Arbitration Agreements—With Particular Consideration Of Class Actions and Arbitration Fees, 5 *J. Am. Arbitration* 251, 254-57 (2006) (emphasis added; footnotes omitted; citing, *inter alia*, Richard Posner, *Economic Analysis of Law* (6th ed. 2003)).

⁶¹ *CFPB Study* at section 10, page 5.

⁶² *Id.* at section 10, pages 6 & n.14 (citing *Ross v. Bank of America*, No. 05-cv-7116 (S.D.N.Y.)).

⁶³ *Id.* at section 10, pages 5-6.

But as the Bureau acknowledges (in a footnote), “the result” of its analysis “has limitations.”⁶⁴ That is a serious understatement. To begin with, while the study uses the language of scientific analysis—describing the settling credit card issuers as a “treatment group” and other issuers as a “control group”—the Bureau states that the “control group” “may or may not have used pre-dispute arbitration provisions” at all.⁶⁵ To be blunt, the Bureau is saying “there was no control group.”⁶⁶

Next, the Bureau was incorrect to assume that issuers who agreed to the arbitration moratorium would definitely raise prices if arbitration had produced cost savings for them. As the George Mason scholars explained in their critique of the Bureau’s study, “the moratorium was only temporary. There is *neither theoretical nor empirical reason* to have thought that such a temporary change in costs would change credit card pricing.”⁶⁷

Finally, and most troubling of all, the Bureau’s report never assesses whether issuers that used arbitration agreements during the time frame studied actually had experienced any cost savings from the use of arbitration—if there were no cost savings, there would be no price increase when arbitration was eliminated. And when one looks at the time frame studied by the Bureau, it is apparent that there were virtually no cost savings to be had because of the state of the law during that time. Specifically, the Bureau purported to examine the total cost of credit (a defined term subject to its own limitations) with a “before” period from November 2008 to October 2009 and an “after” period from January 2010 to November 2011.⁶⁸ But the problem with this time frame is that virtually all of it occurred before the Supreme Court decided *AT&T Mobility LLC v. Concepcion*⁶⁹ in late April 2011—*i.e.*, when arbitration clauses were routinely not being enforced in magnet jurisdictions for consumer class actions (including California, New Jersey, Illinois, and Washington state). When courts do not enforce arbitration agreements and allow class-action lawsuits to proceed, it is self-evident that the company that is party to an arbitration agreement will not experience reduced transaction costs from arbitration.

Economic theory (and common sense) suggest that, in the absence of reduced transaction costs to businesses, there are no cost savings to pass along to consumers. There is no doubt that, as a result of *Concepcion*, courts are today enforcing fair arbitration agreements, compelling arbitration, and dismissing class action lawsuits. As a result, credit card issuers are *now* experiencing reduced transaction costs because of arbitration, and it is reasonable to expect that some of the cost savings from arbitration place downward pressure on the price of credit (although other types of regulation, including by the CFPB, have placed upward pressure on those prices). But the Bureau’s study asks the wrong question by focusing on a time frame

⁶⁴ *Id.* at section 10, page 8.

⁶⁵ *Id.* at section 10, page 8.

⁶⁶ Bizarrely, the report does not identify specific issuers “[f]or maximum protection of supervisory data.” *Id.* at section 10, page 8 n.18. In light of the fact that the Bureau maintains an online database of credit card agreements (<http://www.consumerfinance.gov/credit-cards/agreements/>), this rationale for concealing information about issuers seems doubtful.

⁶⁷ Johnston & Zywicki, *supra* note 41, at 34 (emphasis added).

⁶⁸ CFPB Study at section 10, page 9.

⁶⁹ 131 S. Ct. 1740 (2011).

when no reasonable person would contend that arbitration agreements were being enforced with the regularity needed to lead to reduced transaction costs.

Unlike the retrospective analysis the Bureau undertook focusing on the wrong time frame, the real question, as a matter of public policy, is whether the elimination of pre-dispute arbitration in consumer financial service contracts will force financial services companies to increase prices to customers, and whether the benefits of class action litigation are worth imposing the costs of a CFPB “regulatory tax.” The answer to that question seems clear: “[f]orcing consumers and financial institutions to litigate class action lawsuits will impose enormous costs on what are relatively low-cost transactions,” and these enormous costs will surely “make [their] way to the cost and benefits of the financial products being regulated,” making consumers *worse off*, rather than better off.⁷⁰

⁷⁰ Berger, *supra* note 19.



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STATEMENT FOR THE RECORD

COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
UNITED STATES HOUSE OF REPRESENTATIVES

May 18, 2016

*Examining the CFPB's Proposed Rulemaking on Arbitration:
Is it in the Public Interest and for the Protection of Consumers?*

CHAIRMAN RANDY NEUGEBAUER
RANKING MEMBER LACY CLAY

2128 Rayburn House Office Building

Eric R. Bolinder, Counsel
Cause of Action Institute

Thank you Chairman Neugebauer, Ranking Member Clay, and Members of the Committee for the opportunity to submit this statement for the record. My name is Eric R. Bolinder, and I am Counsel at Cause of Action Institute ("CoA Institute"), a nonprofit, nonpartisan, strategic oversight group committed to ensuring that government decision-making is open, honest, and fair. In carrying out this mission, CoA Institute uses strategic litigation and investigative tools to hold government accountable and educate the general public about the importance of government transparency and accountability.

CoA Institute submits this testimony to highlight an important and, so far, undiscussed issue regarding the Consumer Financial Protection Bureau's ("CFPB") recently proposed arbitration rules.¹ During the Committee's May 18, 2016 hearing, members of the Committee and witnesses detailed the serious shortcomings in the data and scientific methodology

¹ Arbitration Agreements, 81 Fed. Reg. 32,829 (May 24, 2016) (to be codified at 12 C.F.R. pt. 1040) [hereinafter "proposed rules"].

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underlying the CFPB Arbitration Study,² upon which the agency relies for its proposed rules.³ Because the Dodd-Frank Act requires that any arbitration rules proposed by CFPB be “in the public interest and for the protection of consumers,” as well as consistent with the Arbitration Study,⁴ rules that ultimately rely on faulty data and scientific methodology cannot be sustained. That result follows not only from the terms of the Dodd-Frank Act but also from the standards imposed on CFPB by the Information Quality Act (“IQA”).

I. Background

a. The Information Quality Act and OMB Guidelines

The Information Quality Act is a short piece of legislation enacted in December 2000 as Section 515 of the Treasury and General Appropriations Act for Fiscal Year 2001.⁵ The Act directs the Office of Management and Budget (“OMB”) to issue guidance to agencies to ensure the “quality, objectivity, utility, and integrity” of information disseminated to the public.⁶ OMB issued guidelines in 2002, which provided “policy and procedural guidance” on the IQA and further defined statutory terms.⁷ In those guidelines, OMB set “quality” as the general term applicable to information disseminated to the public and established “objectivity, utility, and integrity” as defining terms.⁸ “Objectivity” asks whether information is presented in a “clear, complete, and unbiased manner” and is “accurate, reliable, and unbiased[.]”⁹ OMB adds, “[i]f data and analytic results have been subjected to formal, independent, external peer review, the information may generally be presumed to be of acceptable objectivity.”¹⁰ “Utility” demands that information be useful for intended users.¹¹ “Integrity” ensures that data is free from corruption and falsification.¹²

Both the IQA and OMB Guidelines require agencies to issue their own guidelines that allow “affected persons to seek and obtain correction of information.”¹³ The purpose of this

² CONSUMER FIN. PROT. BUREAU, ARBITRATION STUDY (2015), available at http://files.consumerfinance.gov/f/201503_cfpb_arbitration-study-report-to-congress-2015.pdf.

³ Section 1028 of the Dodd-Frank Act required the CFPB to conduct a study concerning pre-dispute arbitration agreements used “in connection with the offering or providing of consumer financial products or services” and to justify any new arbitration rules consistent with that study. 12 U.S.C. § 5518(a)-(b).

⁴ *Id.* § 5518(b).

⁵ Pub. L. 106-554 (codified at 44 U.S.C. § 3516); see also CONG. RESEARCH SERV., THE INFORMATION QUALITY ACT: OMB’S GUIDANCE AND INITIAL IMPLEMENTATION, Order Code RL32532 (2004), available at <https://www.fas.org/sgp/crs/RL32532.pdf>.

⁶ *Id.*

⁷ Office of Mgmt. & Budget, Guidelines for Ensuring and Maximizing the Quality, Objectivity, Utility, and Integrity of Information Disseminated by Federal Agencies, 67 Fed. Reg. 8452 (Feb. 22, 2002) [hereinafter “OMB Guidelines”].

⁸ *Id.* at 8453.

⁹ *Id.* at 8459.

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.* at 8460.

¹³ *Id.* at 8459-60; see, e.g., *Information quality guidelines*, CONSUMER FIN. PROT. BUREAU, <http://www.consumerfinance.gov/informationquality/> (last accessed May 19, 2016) [hereinafter “CFPB Guidelines”].

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petition process is to challenge the objectivity, utility, or integrity of information and thereby force agencies to issue corrections. In the event of any denial of a petition, the petitioner may lodge an administrative appeal with an agency.¹⁴

b. OMB Peer Review Bulletin

In 2004, OMB issued a memorandum for heads of departments and agencies containing the “Final Information Quality Bulletin for Peer Review.”¹⁵ This bulletin “includes guidance to federal agencies on what information is subject to peer review, the selection of appropriate peer reviewers, opportunities for public participation and related issues.”¹⁶ The bulletin “establishes that important scientific information *shall be* peer reviewed by qualified specialists before it is disseminated by the federal government.”¹⁷

The IQA peer review requirements apply to any influential scientific information disseminated by an agency.¹⁸ OMB defines “dissemination [as] agency initiated or sponsored distribution of information to the public”¹⁹ and “scientific information [as] factual inputs, data, models, analyses, technical information, or scientific assessments based on the behavioral and social sciences, public health and medical sciences, life and earth sciences, engineering, or physical sciences.”²⁰ “Influential scientific information” is “scientific information the agency reasonably can determine will have or does have a clear and substantial impact on important public policies or private sector decisions[.]”²¹

II. The CFPB Failure To Follow IQA Procedures

a. Violation of IQA Quality, Utility, and Integrity Standards

The Arbitration Study does not meet the IQA standards for quality. As Committee witness Professor Jason Scott Johnston explained in a Mercatus Working Paper, “the CFPB’s data do not allow for meaningful comparison between arbitration and class actions[.]” later adding that “[t]hese data suffer from a number of shortcomings.”²²

¹⁴ To date, CFPB claims to have received only one IQA petition, which it granted in part and denied in part. It denied the subsequent appeal. See CFPB Guidelines, *supra* note 13 (“At this time, we’ve received one information quality correction request.”).

¹⁵ Memorandum from Joshua B. Bolten, Dir., OMB, to Heads of Departments and Agencies concerning “Issuance of OMB’s ‘Final Information Quality Bulletin for Peer Review’” M-05-03 (Dec. 16, 2004) [hereinafter “OMB Bulletin”], available at <https://www.whitehouse.gov/sites/default/files/omb/memoranda/fy2005/m05-03.pdf>.

¹⁶ *Id.* at 1.

¹⁷ *Id.* at 2 (emphasis added).

¹⁸ *Id.* at 37.

¹⁹ *Id.* at 35.

²⁰ *Id.* at 36.

²¹ *Id.*

²² Jason Scott Johnston & Todd Zywicki, *The Consumer Financial Protection Bureau’s Arbitration Study – A Summary and Critique* at 6 (Mercatus Center, Working Paper, 2015) [hereinafter “Working Paper”], available at <http://mercatus.org/sites/default/files/Johnston-CFPB-Arbitration.pdf>.

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For example, CFPB presents “data on what consumers recover when arbitrations make a judgment in their favor but no data on what consumers recover when arbitrations settle . . . [inviting] a false apples-to-oranges comparison between class action *settlements* and arbitral *awards*.”²³ Furthermore, CFPB uses “aggregate averages” to evaluate the effectiveness of class action cases. Rather than differentiating the different types of class actions, CFPB lumps them all together.²⁴ This “tends to overweight data from only half a dozen huge class action settlements[]”²⁵ and suggests that individual consumer relief from arbitration, as an average, brings larger benefits to more consumers than class actions.

Elsewhere, Professor Johnston points out that “the CFPB found that arbitration is such a simple and cheap process (now requiring only a \$200 filing fee) that consumers achieve good outcomes even when they are not represented by counsel.”²⁶ CFPB considers one important issue, concerning how arbitration procedures differ from federal court procedures, in the shortest section of the study, making “no attempt in the section to estimate the actual transaction costs that a consumer would face in pursuing an individual claim in federal court rather than in arbitration.”²⁷ Professor Johnston also points out that “the Report fails to indicate whether the CFPB checked to ensure the validity of the econometric technique it used[]” in evaluating price changes between companies with arbitration clauses and ones without.²⁸ The technique CFPB used “is valid only if prices in the two groups of companies had been changing at the same rate before the imposition of the moratorium.”²⁹ CFPB also struggles to properly consider all reasonable interpretations of its results. For example, “CFPB implies that the absence of [] small-dollar claims from the dataset suggests that arbitration is not a feasible dispute resolution procedure for many consumers.”³⁰ In reality, though, it is possible that the absence of small-dollar claims is a result of consumers resolving these low dollar amount disputes “without arbitration or litigation,” instead relying on the bank’s desire “to preserve customer goodwill and relationships.”³¹ In his harshest criticism, Professor Johnston writes,

In perhaps its most glaring omission, however, the CFPB Report makes no attempt to assess the merit of consumer class actions that end in the class action settlements it reports. It does not present any data that even illuminate which firms tend to settle and which do not and how key measures of class action performance (claims rates and attorneys’ fees relative to the class payout) vary with the statutory basis of the claim settled. After reading the voluminous Report, one knows no more about whether the settlement of frivolous consumer class actions is a real social problem than one did before reading it. Likewise, one knows no more about whether arbitration realizes its

²³ *Id.*

²⁴ *Id.* at 7.

²⁵ *Id.*

²⁶ *Id.*

²⁷ *Id.* at 24.

²⁸ *Id.* at 34. Checking the validity of statistical techniques is one of the features of peer review. See *infra* p. 6.

²⁹ Working Paper, *supra* note 22, at 34.

³⁰ *Id.* at 37.

³¹ *Id.*

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promise of achieving more accurate determination of consumer disputes on the legal merits.³²

These are only a sample of the methodological faults in CFPB's study.

As Professor Johnston concludes, the CFPB study's "findings fail to support any conclusion that arbitration clauses in consumer credit contracts reduce consumer welfare or that encouraging more class action litigation would be beneficial to consumers and the economy."³³ The agency's own guidelines state that CFPB "will produce information products that are presented in an unbiased, clear, complete, and well-documented manner."³⁴ And recall OMB's Guidelines, which demand that the information be "accurate, reliable, and unbiased[.]"³⁵ CFPB's report fails to meet these standards.

As explained in a prior report from this Committee, manipulating data follows a pattern of behavior for this agency.³⁶ For example, in an analysis of the indirect auto lending industry, CFPB used a proxy methodology known as "Bayesian Improved Surname Geocoding" to determine the race of individuals, as that information is not available in loan applications.³⁷ That method combines surname and geographical information into a single proxy probability for race and ethnicity.³⁸ In other words, the model establishes the probability of a person's race and ethnicity based on the person's last name and where he or she is from. According to the House Report, the CFPB initially went to great lengths to hide the formulas, computer code, and other internals of the methodology, making it impossible for any critic to test the accuracy of the results.³⁹ Only under pressure from Congress did the CFPB release some details of its methodology, which faced instant scrutiny and was criticized as an inferior proxy method when compared to other available formulas.⁴⁰ Internal communications from the CFPB also showed that the agency knew its proxy was "less accurate . . . than some proprietary proxy methods that use nonpublic data."⁴¹ The CFPB elsewhere acknowledged that its statistical methods were under attack as "racial profiling and junk science."⁴² In a report on the CFPB analysis, Charles River Associates ("CRA"), hired by a consumer credit trade association, the American Financial Services Association, stated that the CFPB methodology was "conceptually flawed in [its] application and subject to significant bias and estimation error."⁴³

³² *Id.* at 55–56.

³³ Working Paper, *supra* note 22, at 6.

³⁴ CFPB Guidelines, *supra* note 13.

³⁵ OMB Guidelines, *supra* note 7, at 8459.

³⁶ U.S. H.R., COMM. ON FIN. SERVS., STAFF REPORT: UNSAFE AT ANY BUREAUCRACY: CFPB JUNK SCIENCE AND INDIRECT AUTO LENDING (2015), *available at* http://financialservices.house.gov/uploadedfiles/11-24-15_cfpb_indirect_auto_staff_report.pdf.

³⁷ *Id.* at 24.

³⁸ *Id.* at 26.

³⁹ *Id.* at 24–25.

⁴⁰ *Id.* at 26–27.

⁴¹ *Id.* at 27.

⁴² *Id.* at 28.

⁴³ Arthur P. Baines & Dr. Marsha J. Courchane, *Fair Lending: Implications for the Indirect Auto Finance Market* at 33 (Nov. 19, 2014) (Charles River Associates (CRA) Report for Prepared for American Financial

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b. Lack of Peer Review

CFPB's Arbitration Study qualifies as "influential scientific information." It was disseminated to the public, includes scientific and data analysis, and will have a clear and substantial impact on important public policies and the private sector. The Study was mandated by statute and is the foundation of a new rulemaking that seeks to alter a long-standing and judicially-recognized dispute resolution process.⁴⁴ If CFPB had followed IQA and the OMB bulletin, the Arbitration Study would have undergone a rigorous, transparent peer review process to ensure the quality of the disseminated information.⁴⁵

Unfortunately, CFPB failed its duty of peer review. CFPB has made no public indication, either in the Arbitration Study itself or accompanying press, that peer review played any part in the Study's preparation.⁴⁶ The lack of peer review, as required under the IQA, together with the flawed methodology and incomplete data highlighted at the May 18, 2016 hearing, raise serious questions about the integrity of CFPB's rules.

III. Conclusion

The track record of CFPB shows that the agency is prone to use incomplete data and poor methodology. Congress enacted the Information Quality Act to prevent such agency abuse and to hold bureaucrats accountable for manipulating data and relying on junk science. CFPB should retract its proposed arbitration rules until it completes a proper peer review of the Arbitration Study and remedies the Study's methodological faults and improper use of data.

Services Association (AFSA)), available at <http://www.crai.com/sites/default/files/publications/Fair-Lending-Implications-for-the-Indirect-Auto-FinanceMarket.pdf>.

⁴⁴ See *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333, 345 (2011) ("our cases place it beyond dispute that the [Federal Arbitration Act] was designed to promote arbitration").

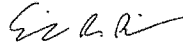
⁴⁵ See OMB Bulletin, *supra* note 15, at 12 ("The National Academy of Public Administration suggests that the intensity of peer review should be commensurate with the significance of the information being disseminated and the likely implications for policy decisions.") (internal citation omitted).

⁴⁶ CFPB's IQA Guidelines contain a blanket disclaimer stating none of the materials the agency produces are subject to IQA and OMB's peer review provisions. CFPB Guidelines *supra* note 13. CFPB may be claiming this under the authority of Section IX of the OMB Peer Review Bulletin, which finds that "accounting, budget, actuarial, and financial information, including that which is generated or used by agencies that focus on interest rates, banking, currency, securities, commodities, futures, or taxes[]" are exempt from peer review. However, neither the Arbitration Study nor the proposed regulations fall under any of these categories. Indeed, it is a social and behavioral study—concentrating not only on award numbers, but also consumer preference and awareness—on how consumers fare in and react to two different circumstances: individual arbitration and class actions.

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Please feel free to contact me by telephone at (202) 470-2396, or by e-mail at eric.bolinder@causeofaction.org, if there is anything further that CoA Institute can provide to the Committee.

Respectfully,



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May 17, 2016

The Honorable Randy Neugebauer
Chairman
Financial Institutions and Consumer Credit
Subcommittee
Committee on Financial Services
House of Representatives
Washington, DC 20515

The Honorable William Lacy Clay
Ranking Member
Financial Institutions and Consumer Credit
Subcommittee
Committee on Financial Services
House of Representatives
Washington, DC 20515

Dear Chairman Neugebauer and Ranking Member Clay:

On behalf of America's credit unions, I am writing regarding tomorrow's hearing entitled, "Examining the CFPB's Proposed Rulemaking on Arbitration: Is it in the Public Interest and for the Protection of Consumers?" The Credit Union National Association (CUNA) represents America's credit unions and their more than 100 million members.

CUNA shares the Subcommittee's concerns about whether this rule is in the best interest of consumers. As the only consumer-owned cooperatives in the financial marketplace, credit unions have a tradition of protecting their members' interests, and in most instances are able to amicably resolve any disputes that arise. Nevertheless, arbitration can be a helpful alternative for credit unions and their members to resolve differences in a fair, efficient, timely, and cost-effective manner.

Credit Unions Dispute Resolution Process is Different than Other Financial Institutions

The Consumer Financial Protection Bureau's (CFPB) arbitration proposal, while not an explicit ban, is a *de facto* ban on the effectiveness of the arbitration process. By removing a tool from the dispute resolution toolbox, it tells credit union members to bypass an efficient and cost-effective resolution process and head straight to the courthouse.

This is troublesome for credit unions, in particular, for at least two reasons. First, it is hard to imagine a case in which class action litigation against a credit union would be a reasonable course of action for credit union members since it would put them in a position of essentially having to sue themselves, as they are member-owners of the credit union. Second, in the rare situation that a group of credit union members feels a credit union is in the wrong, the group, as member-owners, already have direct recourse to remove the credit union's Board of Directors and management using their one-member, one-vote membership powers.

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Straining Credit Union Resources Does Not Benefit Consumers

The arbitration proposal comes in the wake of several recent regulatory changes by the CFPB and other regulators that have made financial institutions more vulnerable to frivolous class-action lawsuits. Eliminating an option while providing no alternative solutions other than to rely on the attorney fee-driven plaintiffs' bar is no solution at all. As an example, onerous regulations concerning the Telephone Consumer Protection Act from the Federal Communications Commission have increased chances that credit unions could be sued for a minor technical violation when trying to communicate with their members using an autodialer. This particular law has no cap on statutory damages. Accordingly, a small credit union facing a lawsuit for a technical violation of the TCPA could essentially be driven out of business for an action such as sending a text message to a group of consumers.

Does it make sense to threaten the existence of one of the safest and most affordable options for consumers to turn to, to right the very minimally offensive wrong of something like receiving a text message? We do not believe it does, and believe that a more reasonable agreement could be reached in arbitration, or another process. Credit unions have a long history of consumer protection, which includes seeking to eliminate regulatory burdens that threaten to make the products and services they offer more expensive or less available. We believe the CFPB's arbitration proposed rule threatens to do this.

A CFPB Arbitration Website Would Primarily Benefit Lawyers Not Consumers

CUNA is also concerned about the CFPB's proposed requirement that companies that use arbitration clauses must submit claims, awards, and other related materials to the CFPB for monitoring and publication on its website. While such requirements would undoubtedly be helpful for trial attorneys seeking to put frivolous class action lawsuits together for the benefit of reaping exorbitant fees, we do not believe there is a significant value for credit union members. To the contrary, we believe it could subject members to privacy and data security violations. Furthermore, we believe this requirement would be duplicative of the CFPB's massive complaint database, which already has several unresolved issues including complaint verification and validation. Truly, the CFPB should spend its time and resources fixing the ongoing issues related to the public facing complaint database.

CUNA Could Support Reforming Abuses in the Arbitration Process, but the Solution is Not a *De facto* Ban on Arbitration

The Dodd-Frank Wall Street Reform and Consumer Protection Act directed the CFPB to study arbitration agreements, with the potential to modify their use. After releasing a study on arbitration it appears that the CFPB's conclusion, rather than making any reforms, to the arbitration process is simply to eliminate all clauses that can stop consumers from joining class

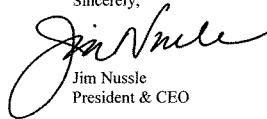
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actions. This seems like yet another missed opportunity to really target any problematic behavior, and instead takes an overly broad approach that completely eliminates an option which, indisputably, can be a much better option than class action litigation for consumers and the economy.

Credit unions strongly support treating consumers fairly as evidenced by the extremely high satisfaction level of our members. However, stacking the cards against credit unions by creating arbitrary regulations, coupled with making it easier for plaintiffs attorneys to target them with frivolous class action litigation, is not helpful for consumers or those working to serve them.

On behalf of America's credit unions, thank you for conducting a hearing on this important issue. We look forward to continuing to work with you on this and other matters of importance to credit unions.

Sincerely,



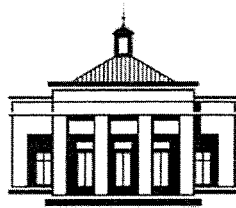
Jim Nussle
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High Cost, Little Compensation, no Harm to Deter: New Evidence on Class Actions under Federal Consumer Protection Statutes

by

Jason Scott Johnston

University of Virginia School of Law

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***High Cost, Little Compensation, no Harm to Deter:
New Evidence on Class Actions under Federal Consumer Protection Statutes***

By Jason Scott Johnston*

Henry L. and Grace Doherty Charitable Foundation Professor
University of Virginia Law School
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Abstract

Working from a sample of all consumer class actions filed in the Northern District of Illinois over the period 2010-2012 (totaling 510), this paper reports and analyzes data on class actions under four federal consumer protection statutes, the Electronic Funds Transfer Act (EFTA) the Fair Credit Reporting Act (FCRA), the Fair Debt Collection Practices Act (FDCPA), and the Telephone Consumer Protection Act (TCPA). Even coding all TCPA cases as alleging actual harm to the named plaintiff, over half the cases in the sample analyzed here seek statutory damages without an allegation of harm to the plaintiff. For most case types, only 15 percent or less of the class receive compensation, and the aggregate compensation paid to the class is far less than the stated or nominal class settlement fund amount. Because courts award attorney fees based on the nominal settlement amount, attorney fees are a very large fraction of the amount paid to the class and for some case types attorney fees average 300-400 percent of the amount paid to the class. The findings of this article have the following implications for class actions under federal consumer protection statutes: i) due to statutory damage provisions, there are no “small dollar” filings under such statutes; ii) such cases are never tried, rarely generate binding legal precedent and may well be individually viable; iii) with low class compensation rates and attorney fees to class counsel that often dwarf total class compensation, such class actions are both highly ineffective and inefficient; iv) statutory damages provisions with no requirement to even plead harm incentivize class counsel to pursue claims where there is no harm to compensate or deter, and even cases with allegations of harm (as under the TCPA) may actually involve no harm as courts have created a presumption of harm (as in presuming the lack of consent under the TCPA).

Suppose someone proposed a hypothetical system of compensatory wealth redistribution to consumers where the fees paid to the intermediaries accomplishing the distribution often dwarf the amount paid to consumers. Suppose that in this same system, the redistribution was so random that only a small fraction of consumers ever received any payments at all. Suppose that this same person proposed a hypothetical system of deterrence in which the conduct being deterred with civil damages more often than not causes no harm to anyone. And now suppose, finally, that someone proposed to combine all these systems into a single, complex and exorbitantly expensive institution.

One might well suppose that no rational person could actually support the creation of this institution. And yet – based on data my research assistants and I have collected on

* Thanks for detailed comments on this paper go to Richard Hynes. Useful comments on this paper were made by participants in workshops at the University of Virginia and George Mason University Law Schools. I am especially grateful to University of Virginia Law School student research assistants William Jordan, Lauren Kramer and Levi Swank, all of whom were crucial to the success of this project, and to Jon Ashley of the University of Virginia Law Library, who helped at several stages of data collection.

all consumer class actions filed in the Northern District of Illinois over the period 2010-2012 – class action lawsuits under federal consumer protection statutes constitute precisely such a system.

In this paper, the first in a series of papers based on our Northern District of Illinois database, I begin by briefly describing how we identified consumer class actions filed in the Northern District of Illinois and by situating those filed under federal consumer protection statutes within the larger set of all consumer class actions brought under both state and federal law. The more detailed empirical and qualitative analysis to follow in this paper concentrates on the four federal consumer protection statutes that made up the majority not just of class actions under federal consumer protection statutes but of all consumer class action filings in our chosen federal court: the Fair Debt Collection Practices Act (FDCPA), the Fair Credit Reporting Act (FCRA), the Electronic Funds Transfer Act (EFTA), and the Telephone Consumer Protection Act (TCPA). Empirical analysis focuses on how class action outcomes, and in particular the terms of class action settlements, differ both across these statutes and across different case types under the same statute. The outcomes I focus on are the magnitude of attorney fees to class counsel – a core element of the total cost of consumer class actions – and the actual aggregate amount paid to class members and the fraction of the class that receives payment (the compensation rate) – measures that describe how well class actions perform as institutions for mass compensation.

In brief summary, the empirical findings described and analyzed below show that at least half of the class actions in our sample, the plaintiff does not allege injury but relies solely upon statutory provisions awarding damages without proof of harm. With or without harm allegations, over 80 percent of filings end in settlement. Individual settlement (in which the named plaintiff settles and dismisses the individual action with prejudice) occurs in over 50 percent of cases, while class settlement rates range from 20 to almost 40 percent. Such class settlements generally compensate only a small fraction of the class but compensation rates (the fraction of class members who actually receive compensation) vary tremendously across case types even for cases brought under the same statute. Most case types seeking statutory damages with no allegation of injury to the plaintiff have compensation rates around 15 percent. However, for some case types, such as class settlements involving allegations that a debt collector attempted to collect on time-barred debt, compensation rates are much higher, sometimes exceeding 50 percent of the class.

Importantly, our research shows that the amount paid to the class is not the nominal or stated settlement amount. In a typical class settlement, because few class members fill out valid claim forms, the actual aggregate amount paid to class members is for most case types a very small fraction of the nominal or stated settlement amount. Courts clearly base attorney fees on the nominal or stated settlement amount (indeed, there is almost a perfect correlation between the nominal settlement amount and the attorney fees). Because courts base attorney fees on the nominal settlement amount and not the actual money paid to class members, attorney fees are a very large fraction of the actual class recovery, with attorney fees often equal to 300-400 percent of the actual aggregate class recovery.

Thus the data found in the Northern District of Illinois for the period 2010-2012 depict class action settlements under federal consumer protection statutes as a mechanism

of compensation whose cost far exceeds actual class recovery and which award recovery only to a small fraction of class members. Moreover, in about half such settlements, a class settlement is reached under a statutory damage provision that has relieved the plaintiff of any burden even to plead that she suffered harm. The conduct in such cases is typically a failure to follow notice and disclosure formalities – as under the FDCPA or EFTA – or a harmless clerical error – as in FCRA cases where a credit card receipt is printed with the expiration date of the card. Most settling defendants in such cases are small or medium sized firms who have clearly violated a statutory provision, but perhaps one of which they may have been unaware, and certainly one that has caused no harm to deter with the massively expensive machinery of the class action.

The empirical findings about class settlements presented in this article illuminate a variety of significant public policy and legal issues regarding the performance of the consumer class action. Few civil justice institutions have been subject to as much praise and criticism as the consumer class action. To supporters, the consumer class action is essential to the vindication of consumer rights in cases involving widespread but small dollar harms. Arguing that such small dollar claims represent “most” consumer claims, Adam Levitin¹ has argued that preventing such class actions “is a license for unscrupulous businesses to steal from their customers.” Without the class litigation device, he has argued, courts opinions that produce legal precedents will not be written, leaving both businesses and trial attorneys in the dark as to consumer legal rights.

Critics question these supposed merits of class actions. For example, George Priest² has argued that class actions threaten firms with massive discovery costs and induce them to settle claims for huge amounts of money “where there appears to be no substantive basis for liability.” Martin Redish has argued that as in many class settlements, the actual class members receive hardly any “real” compensation with the aggregate class compensation dwarfed by attorney fees, class actions represent a “wholly improper and unacceptable departure from the fundamental precepts of American democracy.”³

The findings reported below illuminate many of the points in this debate. They clearly show that class action settlements are much more effective in transferring money from the defendant to class counsel than in actually compensating class members. They also show that rather than incentivizing the pursuit of class claims involving small dollar harm to class members, federal consumer protection statutes have incentivized class counsel to bring suits based on statutory damages, often amounting to \$1000 per class member or more, in cases where there may be no individual harm at all. On the other hand, such suits are far from frivolous, as they involve easy- to-prove violations of clear statutory requirements.

In recent years, the Supreme Court has issued a number of opinions restricting the availability of class action relief. While some of these do not involve the kind of

¹ Adam J. Levitin, Mandatory Arbitration Offers Bargain-Basement Justice, *American Banker*, May 13, 2014, available at <http://www.americanbanker.com/bankthink/mandatory-arbitration-offers-bargain-basement-justice-1067419-1.html>.

² George Priest, What we Know and Don't Know about Modern Class Actions: A Review of the Eisenberg-Miller Study, Manhattan Institute, Civil Justice Report No. 9 (Feb., 2005).

³ Martin H. Redish, Class actions and the democratic difficulty: rethinking the intersection of private litigation and public goals, 2003 U. Chi. Legal F. 71, 77 (2003).

consumer class action studied here,⁴ during its 2015-2016 term, the United States Supreme Court has heard two cases – *Campbell-Ewald Co. v. Gomez*⁵ and *Spokeo, Inc. v. Robins*⁶ that arose under two of the federal consumer protection statutes studied below (respectively, the TCPA and FCRA). *Campbell-Ewald* involved the procedural question of whether a class defendant can effectively moot a class action by offering to pay full judgment to the named plaintiff before that plaintiff moves to certify the class. As discussed below, this was a tactic used by defendants in one type of case in our dataset, causes of action alleging that an ATM provider violated the EFTA by failing to have a notice of fees “on or at” the ATM machine. But it was a tactic that after a few months of early success eventually disappeared from use, as class counsel avoided the problem by moving quickly to certify the class or simply telling the court that they would soon do so.

If our data reveal that the *Campbell-Ewald* offer of judgment/mootness issue is of little practical significance, the same is not true of the issue in *Spokeo v. Robbins*. *Spokeo* is a class action seeking statutory damages of \$100 to \$1000 under FCRA against a “people search engine” website that allegedly misstated information about the plaintiff’s age, marital status, education and professional experience. FCRA permits statutory damages without requiring proof of harm for the publication of a false report. The defendant in *Spokeo* has argued that such no-harm class actions cannot be brought unless the plaintiff establishes constitutional, Article III standing by alleging that she did indeed suffer an actual injury. Both houses of Congress have recently passed legislation that would require class members to have sustained an actual injury of the same sort alleged by the named plaintiff.⁷ By showing that such no harm class actions make up about half of all the filings, the discussion below shows that a decision by the Court calling into question the constitutionality of such no harm filings or a statute requiring allegations of harm could have major consequences for class actions under federal consumer protection statutes.

The empirical findings in this article are also relevant to the major market alternative to class action litigation, mandatory consumer arbitration. For years, many state courts and consumer advocates have decried clauses in consumer contracts requiring consumers to arbitrate disputes under those contracts and prohibiting consumers from bringing (or joining) class action lawsuits. Literally for decades, they have argued that arbitration cannot adequately substitute for the class action as an instrument of compensation and deterrence. In *Discover Bank v. Superior Court*,⁸ for example, the California Supreme Court reasoned that because “damages in consumer cases are often small,” without the availability of class actions, there would no way to stop companies from wrongfully extracting small amounts from consumers.⁹ Until very recently, it seemed that these arguments against the enforceability of class action waivers had been conclusively and finally rejected by the Supreme Court. In *AT&T Mobility v.*

⁴ For example, in *Wal-Mart v. Dukes*, 564 U.S. ____ (2011), the Court held that it was wrong for the lower courts to certify a class action in a case alleging employment discrimination because class members did not satisfy the commonality requirement of Federal Rule of Civil Procedure 23.

⁵ No. 14-857 (slip opinion, Jan. 20, 2016).

⁶ 742 F. 3d 409 (9th Cir. 2014), cert. granted ____ S.Ct. ____ (April 27, 2015)

⁷ H.R. 1927, the Fairness in Class Litigation Act, recently passed by both Houses [see...]

⁸ *Discover Bank v. Superior Court*, 113 P.2d 1100 (Cal. 2005).

⁹ *Discover Bank* at 1109.

Concepcion,¹⁰ the Court held that by forbidding arbitration clauses that preclude class-wide civil and arbitral relief, the the *Discover Bank* approach runs afoul of and is preempted by the Federal Arbitration Act. Two years after *Concepcion*, in *American Express v. Italian Colors Restaurant*,¹¹ (*Amex II*), the Court enforced a clause mandating arbitration and waiving class-wide relief even for claims alleging violations of federal antitrust law. However, in its March, 2015 Final Report on Arbitration, the Consumer Financial Protection Bureau presented data that many people, including dozens of members of Congress, interpreted as showing that class actions are a much more effective way than arbitration to compensate consumers injured by and thereby deter misconduct by providers of consumer financial products and services. Later in 2015 the CFPB cited its own Report, and in particular the Report's findings on the performance of consumer class actions, as justifying its proposal to ban mandatory consumer arbitration clauses.

The next part of this article describes the method of data collection and situates the filings studied in detail in this paper within the larger, full sample of consumer class actions that we gathered from the Northern District of Illinois. It then reports on class action outcomes under different statutes and causes of action within statutes. The final two parts of the article sketch implications of the empirical findings for the social utility of consumer class actions and suggest some possible policy responses to the problems with consumer class action identified in our data.

II. The Northern District, Illinois Evidence

A. Federal Statutory Consumer Class Action Case Types and Outcomes

In this section, I clarify how we constructed our sample and show the overall distribution of case types – those brought under both federal and state law – within the sample. I then show the distribution of outcomes for the federal statutory case types that are discussed in detail in the remainder of the paper.

1. The Data underlying this Study

The class action sample studied here was drawn from cases filed in the Northern District of Illinois (hereafter “ND Ill”) between January 1, 2010 and December 31, 2012. The Northern District was chosen because prior work by Fitzpatrick¹² suggested that this is a court that sees a fairly large number and broad range of types of consumer class actions. All data come from the federal court PACER electronic database of docket sheets. Appendix 2 (to be included in the final pre-publication version) describes the search terms used in identifying consumer class actions in the ND Ill docket dataset. Our search criteria defined “consumer class actions” so as to exclude securities class actions and antitrust class actions. On the other hand, we meant to include in our study any other type of class action brought on behalf of consumers under both federal and state laws, including the common law. The federal consumer protection laws that are discussed in

¹⁰ 563 U.S. 333 (2011).

¹¹ 470 U.S. 213 (2013).

¹² Brian T. Fitzpatrick, An Empirical Study of Class Action Settlements and Their Fee Awards, 7 J. Emp. Legal Stud. 811 (2010).

the present paper define “consumer” more broadly than does the dictionary. Under the Fair Credit Reporting Act (FCRA), an employment background check is a “consumer report.” For this reason, we included FCRA cases involving employment background checks in our sample. Similarly, doctors and dentists with small offices often receive unauthorized telemarketing faxes, and such doctors and dentists are “consumers” protected under the Telephone Consumer Protection Act’s (TCPA’s) prohibition on sending such unauthorized communications. Hence the doctor and dentist unauthorized fax cases were included in our dataset.

In gathering information about the type and resolution of consumer class actions, my research assistants and I eschewed further reliance on machine coding and worked directly with docket sheets and the documents to which such sheets provide links. We identified the type of class action, both legally, factually, and amount claimed, from the complaint.¹³ We identified the resolution of each case by relevant docket entries. Many of these are straightforward. If, for example, a case ended when the court granted the defendant’s summary judgment motion, that would clear from the docket sheet entry and there would typically be an opinion written to justify the summary judgment order.

Similarly, class action settlements must be approved by the court as fair, and class counsel submit memoranda in support of both preliminary and final approval of the class action settlement. Class counsel also submit memoranda in support of attorney fees awards. The exhibits attached to these memoranda virtually always include affidavits from the settlement administration company reporting on how many class members were notified and how many filed valid claims and similar information. If they do not contain such information, then memoranda written to justify an award of attorneys fees typically contain such information, as well as information about the hours spent on the case, the proportional relationship between attorney fees and the nominal settlement amount typical of similar cases in the ND Ill and elsewhere around the country, plus other information detailing how the settlement funds will be paid out. These memoranda and their supporting exhibits are our primary source for information about class settlements. Rarely did district courts actually write opinions explaining why they found a class settlement to be fair. For a small number of class action settlements, there are not even any formal memoranda from counsel justifying the fairness of the settlement, just an order from the court approving the settlement. It is noteworthy that in our entire sample of about 500 consumer class action filings, we found not a single district court opinion ultimately declining to approve a class action settlement.

Individual settlements are a bit more difficult to precisely identify. In some docket sheets, there are entries indicating that the parties are discussing settlement and have reached an individual settlement. In many other docket sheets, there are entries to the effect that the parties are negotiating or have reached an individual settlement. In all of these, the case is resolved with the entry of an order dismissing the individual claim with prejudice and the class claims without prejudice. In a minority of other cases, the same final order is stipulated to and entered, but there are no prior entries to the effect that the case has settled individually. We count all of these case types as an “individual settlement.”

¹³ In some filings under multiple statutes, we used the entire history of the case, as drawn from docket sheets, to categorize the case under the statute under which the action actually proceeded.

2. Relationship to Prior Empirical Studies of Consumer Class Actions

When it comes to the actual performance of consumer class actions as an instrument of compensation or deterrence, what is most striking is how little we know. Indeed, the only other systematic study of class actions drawn from a search of all case filings (as opposed to reported opinions and other selective reports) appeared only in March, 2015. By far the largest study of consumer class action outcomes and settlements that has yet been undertaken was that done by the CFPB for its March, 2015 Arbitration Report.¹⁴ The CFPB attempted to identify all consumer class actions filed in federal court (and for selected state courts) over the period 2010-2012 that involved one of six product categories that the CFPB categorized as a “financial product.” The CFPB looked at all federal courts, whereas the study here is based on a sample from one court, the Northern District of Illinois. The CFPB looked at the same time period examined here, and its methodology was similar to that employed here, in that the CFPB searched complaints and other docket items that are available electronically.¹⁵ However, the CFPB’s focus was to find all federal filings involving one of its six consumer financial product categories, whether brought as an individual action or a class action. Here, the objective was to identify all consumer class actions.

Similarly, in identifying and reporting on class action settlements (over a longer time period, 2008-2012), the CFPB looked across all federal courts but searched only for class settlements in cases involving one of the products it was studying. In this study, we identified class settlements in any of the consumer class actions filed in the N.D. Ill. between 2010-2012. Some other differences in search methodology between this study and the CFPB’s will be discussed in Appendix 2. As the CFPB’s is a very large study, which employed a similar search methodology (albeit applied to a larger sample) to that used here, at several points below I compare the CFPB’s findings to ours. In my discussion of the policy implications of our findings, I argue that the way the CFPB chose to categorize case filings, and the kind of aggregate data that it reported are both seriously misleading for purposes of policy design.

The only other study of consumer class actions that gathered data directly from docket sheets was one done recently by Fitzpatrick and Gilbert.¹⁶ That study, however, looked at only fifteen class action settlements in class actions challenging bank overdraft on a variety of state law theories. The cases were chosen simply because one of the authors was a coordinating lead class counsel in one of the cases. The Fitzpatrick and Gilbert study does not purport to be representative and as explained below, the overdraft fee class action settlements are indeed highly unrepresentative when viewed within the context of the much larger and more representative sample studied here.

¹⁴ CFPB, Arbitration Study: Report to Congress 2015 (March 10, 2015), available at <http://www.consumerfinance.gov/data-research/research-reports/arbitration-study-report-to-congress-2015/>.

¹⁵ In the LexisNexis Courtlink electronic database, which includes the docket entries found in PACER that were used in this paper.

¹⁶ Brian T. Fitzpatrick and Robert C. Gilbert, An Empirical Look at Compensation in Consumer Class Actions, Vanderbilt University Law and Economics Working Paper No. 15-6 (2015), available at http://papers.ssrn.com/sol3/Papers.cfm?abstract_id=2577775.

The empirical study most closely related to the present paper is a recent study by Shepherd.¹⁷ Shepherd's team used a variety of search criteria and identified 2158 class action settlements over the period 2005-2015 in cases involving no allegation of an injury, where statutory damages provided the sole ground for relief. As explained in the introduction, by looking at all consumer class actions,¹⁸ the present study shows that such no injury class action settlements are a very large fraction of all consumer class settlements under the federal statutes studied here. Thus I am reporting here on the same types of settlements that Shepherd reports on but also other types. Moreover, I focus here on how class action outcomes and settlements vary across statutes and across case types under the same statute. I focus on three aspects of such settlements: the actual aggregate payout to the class, how it compares to the nominal settlement amount and to attorney fees, and the actual fraction of the class that receives compensation (the compensation rate). Shepherd does not break out these variables by case type but reports only "percentage to class members" and other payouts across the four main no injury federal statutes (FDCPA, TCPA, FCRA and EFTA). For this reason, one cannot compare outcomes reported on below with those that Shepherd reports.

Earlier empirical work on consumer class action settlements was based on much smaller and more selective samples than the sample studied here. Fitzpatrick¹⁹ included consumer class action settlements in a more general study of federal class action settlements over the years 2006-2007. However, he identified cases with class settlements from highly selective lists -- such as published class action reporters and district court opinions -- and only then turned to electronic docket sheet data for class settlement details. The focus of Fitzpatrick's paper is on the determinants of attorney fees in class settlements and the size of such fees relative to the class settlement. As Fitzpatrick found hardly any variation in fees relative to settlements -- with a ratio clustering around 25 to 30 percent -- it seems clear that he did not obtain and analyze data on the actual aggregate payout to the class. That is, his work focused only on what I call the nominal settlement amount, which is the amount stated in the settlement agreement and court order and which is almost always much greater than the actual payout to the class.

¹⁷ Joanna Shepherd, *An Empirical Survey of No-Injury Class Actions*, Emory University Legal Studies Research Paper No. 16-402 (Feb. 2016) available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2726905.

¹⁸ There seem to be differences in how Shepherd's team identified and gathered information on class settlements. She reports that the team got data on class settlements from "final orders, settlement agreements, and various other court documents such as those approving settlements and attorneys' fee awards." In our own work with PACER docket sheets, we discovered that information on key features of class settlements, such as attorney fees and the actual compensation rate for the class, is generally not included in final orders or opinions (indeed there are few opinions approving class settlements, just uninformative orders). Such information is available in the memoranda and supporting exhibits that class counsel submit when they move to have the class settlement and attorney fee request approved. It is not clear whether Shepherd's team accessed such memoranda and exhibits.

¹⁹ Brian T. Fitzpatrick, *An Empirical Study of Class Action Settlements and Their Fee Awards*, 7 J. Emp. Legal Stud. 811 (2010).

A more thorough attempt to identify the actual aggregate payout to the class was made in a recent study the law firm of Mayer Brown LLP.²⁰ However, that study looked at a very selective sample, based on reports of class action settlements, and therefore is not comparable to the full docket filings dataset analyzed here. As with the CFPB and Shepherd studies, differences between the findings in this earlier work and our findings will be commented upon below.

Before the electronic availability of full federal court docket sheets, it was as a practical matter impossible to study class action outcomes empirically. In a 2008 study, Pace and Rubinstein²¹ attempted to get information on the amount of class action settlements that were actually distributed – that is paid – to the plaintiffs. They looked at the official case files in 31 federal class action settlements, and also interviewed judges, lawyers and settlement administrators involved with 57 class action resolutions. They had a difficult time learning anything, as just six of their 31 cases files had information on either the number of claims paid or the total amount of compensation, while only 14 out of 222 (6 per cent) of lawyers, judges and claims administrators contacted actually responded with information on case outcomes and claims distribution, providing information on just 11 out of 57 cases.

Pace and Rubinstein say they learned “very little” from the six case files, discovering that in the four cases where distribution was automatic (mailing a check to a known class member), a high percentage of victims received compensation (ranging from 76 to 99 percent of the class), while in class actions where plaintiffs had to fill in a form to receive compensation, only four per cent of the class received a small recovery (of \$30 per victim) and only 20 per cent received a much more significant amount (\$1000).²² These class actions – where victims had to fill out forms to receive compensation – made up the majority of the cases for which Pace and Rubinstein did not have distribution data, suggesting that compensation rates in the typical class action is in the lower, four to twenty per cent range. As for the 9 class actions about which Pace and Rubinstein received claims distribution information from attorneys, judges and claims settlement administration companies, three cases had distribution rates below 5 per cent, four between 20 and 40 per cent, and two with rates above 50 per cent (with a maximum of 82 per cent).²³ It was in the largest class actions, with hundreds of thousands or millions of class members, where distribution rates were the lowest. This was true even for class actions with non-minute recovery amounts, such as \$1500.

While hardly based on a large, representative sample of class actions, Pace and Rubinstein’s finding that only a small fraction of class members received compensation when compensation is not automatic is consistent with other existing findings on class action compensation rates. In a study of insurance class actions, Pace, Carroll, Vogelsang

²⁰ Mayer Brown LLP, Do Class Actions Benefit Class Members (2013), available at <https://www.mayerbrown.com/files/uploads/Documents/PDFs/2013/December/DoClassActionsBenefitClassMembers.pdf>.

²¹ Nicholas M. Pace and William B. Rubinstein, How Transparent are Class Action Outcomes? Empirical Research on the Availability of Class Action Claims Data (Rand, Civil Justice Institute Report WR-599-ICJ, July 2008).

²² Pace and Rubinstein, p. 24.

²³ Pace and Rubinstein, 32.

and Zakaras,²⁴ received survey responses from 57 large insurance companies who reported data on 748 distinct class actions, 89 per cent of which had been filed in state court. In 7 of 23 cases with complete payout and attorney fee information, the median distribution rate to actual plaintiffs was 79 per cent, but in another quarter of the cases, the distribution rate was 13 per cent, while in 3 per cent of the cases, only 4 percent of the net compensation fund was paid. In ten of the cases in which potential class size and number of claims paid were reported, 100 per cent of the class member received some compensation, but in the worst case, only 1 per cent of the estimate number of class members received anything, and in the median case, just 15 per cent of the potential class received any compensation.²⁵ Still earlier work by Hensler et al.²⁶ studying ten class action settlements in detail found a range of class settlement distribution rates from 100 percent to only 30 percent, with less than 1 per cent of some subclasses receiving compensation. As did Pace and Rubinstein, Hensler et al. found that distribution rates were highest in cases where payouts were automatic, and lower when class members actually had to fill out a form.

3. Class Actions Under Federal Consumer Protection Statutes Within the Universe of Consumer Class Action Filings

The case types analyzed in this article are an important fraction of all consumer class action filings in my Northern District of Illinois dataset. This can be seen from Figure 1 below, which presents the frequency distribution for the 506 class action filings in the N.D. Ill. dataset. As shown in the Figure, there were 131 filings under the Fair Debt Collection Practices Act (FDCPA), 127 filings under the Telephone Consumer Protection Act (TCPA), 53 filings under the Fair Credit Reporting Act (FCRA), 43 under the Electronic Funds Transfer Act (EFTA) and 20 under federal privacy protection statutes other than FCRA (such as the Video Privacy Protection Act).

The 375 filings under federal consumer protection statutes comprise 74 percent of all filings in the sample. It is noteworthy that filings under federal statutes made up 71.7 percent of all filings in the CFPB's much larger sample of consumer financial products case filings in federal court over 2010-2012.²⁷ This indicates that in terms of the frequency of federal statutory causes of action, the case types found in our ND. Ill. dataset are likely typical of consumer filings in other federal courts.

All of the other filings types, such as those called "false/deceptive advertising" and "products liability" in Figure 1, are brought under state consumer protection statutes and/or involve common law claims. These state law consumer class actions will be discussed and analyzed in detail in a subsequent article. Figure 1 itself suffices to describe some state law case types – such as those involving products liability (defective

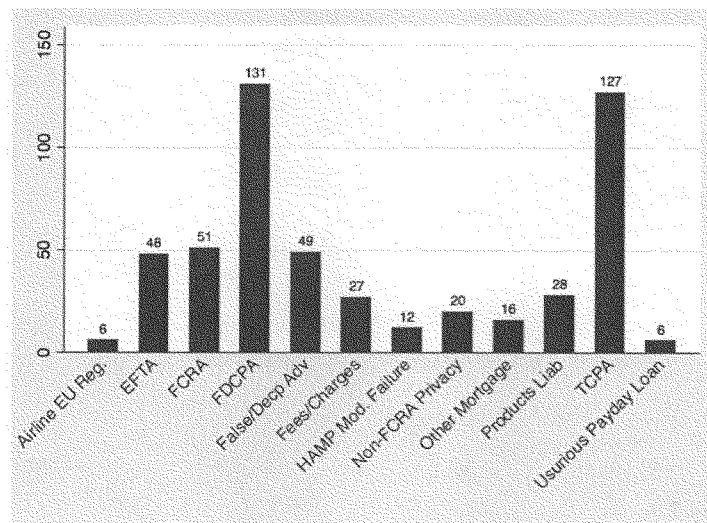
²⁴ Nicholas M. Pace, Stephen J. Carroll, Ingo Vogelsang, Laura Zakaras, *Insurance Class Actions in the United States* (Rand, 2007).

²⁵ Pace et al., *Insurance Class Actions*, *supra* at xxiii.

²⁶ Deborah Hensler, Nicholas Pace, Bonita Dombrey-Moore, Beth Giddens, Jennifer Gross, and Erik Moller, *Class Action Dilemmas: Pursuing Public Goals for Private Gains* 445 (Rand, 2000).

²⁷ CFPB Final Arbitration Study, *supra* note ____ at Section 6, p. 21.

products) claims and those alleging false and deceptive advertising. Other types require quick clarification. Those categorized as involving “fees and charges” challenge the imposition of such fees and charges in various consumer contracts on a variety of state common law and statutory theories. HAMP mortgage modification failure cases arose from the federal Home Affordable Mortgage Program and alleged that financial defendants were liable for failing to modify mortgages as they promised pursuant to that program. “Other mortgage” claims in Figure 1 include a congeries of alleged violations arising from mortgage origination and servicing. Usurious payday loan claims alleged precisely that. The final category of claims did not arise under state law but instead alleged that various airline defendants failed to compensate passengers for international flight delay or cancellation as required by European Union regulations 261.



**Figure 1. Number of Consumer Class Action Filings, N.D. III. 2010-2012
By Case Type**

3. Outcomes in Class Actions under Federal Consumer Protection Statutes

The first in a series of articles analyzing the ND III. consumer class actions depicted in Figure 1, this article analyzes only class actions under federal consumer protection statutes. While much more detail is given below about the types of claims brought under the various federal consumer protection statutes, a brief description of these statutes is in order now. The most frequently occurring federal consumer protection class action is brought under the FDCPA. That statute imposes various formal requirements on debt collectors, such as registration as and disclosure of identity as a debt collector, and it also contains substantive protections for consumer debtors. It bars a

variety of abusive debt collector practices, such as dunning consumers on time-barred debts without disclosure of that fact, making harassing phone calls (sometimes using auto-dial and pre-recorded messages) attempting to collect debts, using false and misleading information about the balance of the debt, and attempting to embarrass debtors by calling third parties.

The next most commonly occurring case types, brought under the TCPA, alleges that the defendant sent unauthorized and unsolicited text messages, phone calls or emails to the plaintiffs' cell phones or sent an unauthorized fax. Such messages are sent either as part of the debt collection process or else as part of a telemarketing program.

The vast majority of EFTA filings in this sample, the next most frequently occurring case type, alleged that the defendant failed to post a physical notice of the fees charged for use of an automated teller machine (ATM) as the EFTA then required.

Filings under FCRA, the final filing type discussed in detail here, alleged either statutory violations in the use of an employment background check report (which is a "consumer report" under FCRA) or else a violation of statutory privacy protection under FCRA (most commonly that the defendant retailer printed out a receipt that displayed too many digits of the plaintiff's credit card number).

Putting aside the category of "non-FCRA privacy," about which some brief remarks are made later,²⁸ by February, 2016, almost all -- 338 out of 365 or 93 percent -- of cases filed under the four main federal consumer protection statutes (FDCPA, TCPA, FCRA and EFTA), had terminated. The distribution of outcomes under these four primary federal consumer protection statutes are depicted in Table 1 and graphically in Figure 1 below.

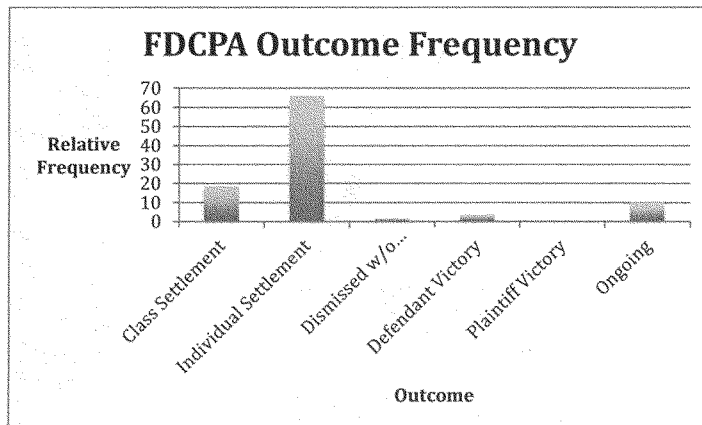
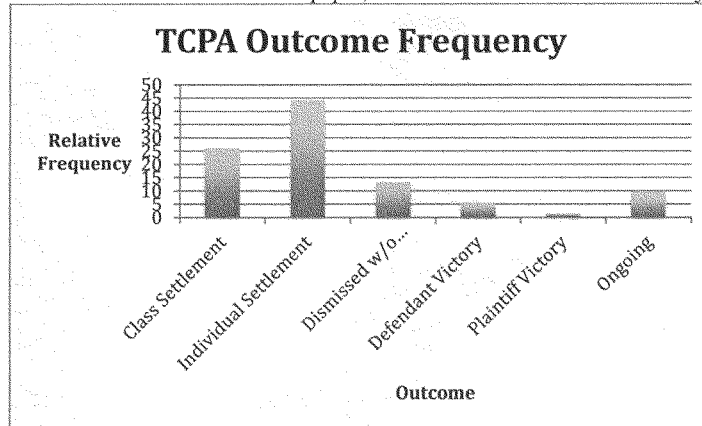
Case Type	Total Resolved Cases	Class Settlement	Individual Settlement	Dismissed Without Prejudice	Defendant Victory	Plaintiff Victory
TCPA	113	.28	.51	.15	.06	.00
FCRA	51	.37	.50	.06	.06	.00
FDCPA	122	.21	.70	.06	.02	.01
EFTA	43	.19	.59	.00	.20	.02

Table 1. Outcome Probabilities by Statutory Case Type

As can be seen from the table, there is substantial variation across case types in the relative frequency of various outcomes. I argue in the substantive discussion below that this variation is in large part due to differences in statutory causes of action. However, it is worth noting that for the only three claim types that survive (as I discuss immediately below, Congress has eliminated the ATM notice failures in my sample as a cause of action under EFTA), between 87 and 93 percent of all claims are resolved in either an individual or class settlement. Such high settlement rates are indicative of civil litigation generally. In this sense, consumer class actions under federal consumer protection statutes are similar to civil litigation more generally. In another respect, they seem very different. In only four cases total did the plaintiff achieve a judgment in its favor (2 TCPA cases, 1 FDCPA case and 1 EFTA case). All three of these were default judgments. In this sample, plaintiffs *never* actually had their substantive claim

²⁸ And analysis of which will be included in the final draft version of this article later in 2016.

adjudicated on the merits by a judge or jury. Finally, defendant victories were judgments on 12(b)(6) motions to dismiss or on motions for summary judgment. In the roughly 370 resolved cases discussed in this paper, no case ever went to trial before a judge or jury.



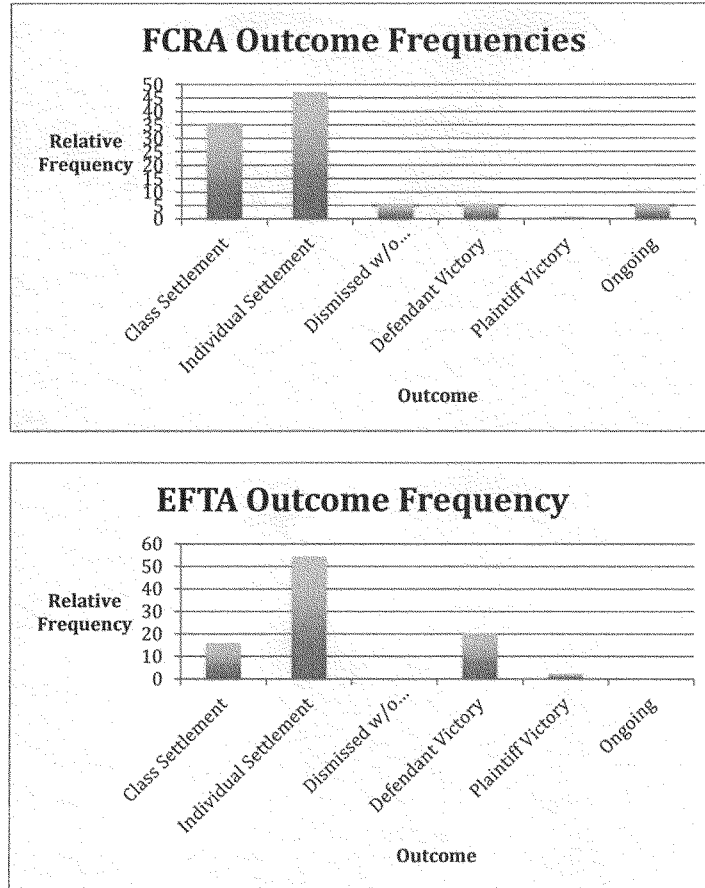


Figure 1. Outcome Frequency Across Different Statutory Case Types

B. Lessons from an Extinct Cause of Action: ATM Notice Failures under the Electronic Funds Protection Act (EFTA)

In an ATM notice failure case, the plaintiff alleged that an ATM provider failed to post a notice of the fees charged “on or at” an ATM as was then required by the federal Electronic Funds Transaction Act. As explained by the Consumer Financial Protection

Bureau (CFPB) in a 2013 rulemaking,²⁹ in 1999, Congress amended Section 904(d)(3) of the EFTA to require a notice of the actual fee charged to a consumer for using the machine on the screen of the machine and also a notice “on or at” the machine that a “fee is imposed” for using the machine. As the CFPB explained,³⁰ the “on or at” notice “usually involved a sticker placed on the machine by the ATM operator.” Under EFTA Section 916, failure of an ATM operator to provide the required notice could trigger liability in an individual or class action for actual damages, costs and attorneys’ fees, and statutory damages of between \$100 and \$100 per plaintiff without proof of harm (class damages are capped at the lesser of 1 percent of the defendant’s net worth or \$500,000). Under Section 910(d), ATM operators could escape such liability only if they could show that the “on or at” ATM notice had been damaged or removed by someone else.³¹

In December, 2012, Congress voted to eliminate the ATM “on or at” notice requirement from the EFTA.³² Thus cases alleging that the failure of an ATM to comply with this notice requirement violates EFTA are now extinct. However, in several respects, these extinct ATM cases perfectly illustrate a class action case type that as we shall see still survives under many federal consumer protection statutes: a case where no class member has actually suffered any injury but which is nonetheless settled, where the nominal settlement is far less than the actual amount paid to class members, and where that amount – the actual compensation received by the class – is dwarfed by the attorney fees received by class counsel. For this reason, ATM notice failure class action settlements are an interesting and important case study.

To our considerable surprise, we found that over the period 2010-2012, there were 43 of these ATM notice failure class actions filed in the ND Ill. In every such case, the complaint alleged that a particular ATM machine somewhere in metropolitan Chicago failed to have the required “at or on” notice on a date when the named plaintiff used the machine. Such complaints were supported by photos allegedly showing the state of the machine on the date it was used by the plaintiff. They invariably sought statutory damages of up to \$1000 per class member, plus attorneys’ fees and costs. As shown in Table 2 below, the outcomes of such litigation quite clearly evolved over the sample period, but over the entire period, 74 percent of the ATM notice failure cases ended in either a class or individual settlement. In this sense, the cases were very successful.

²⁹ See CFPB, Amendments to Disclosures at Automated Teller Machines (Regulation E) (March 20, 2013), available at http://files.consumerfinance.gov/f/201303_cfpb_Final-Rule-Amendment-to-Reg-E-re-ATM-Disclosures.pdf.

³⁰ CFPB Amendments to Disclosures, *supra* note __ at 3.

³¹ 15 U.S.C. Sections 1693(m)(a) and (h)(d)

³² In Public Law 112-216, deleting the “on or at” requirement plus some other obsolete language from Section 904(d)(3) of EFTA.

	Number of ATM notice class actions filed	Cases Dismissed without Settlement (defendant victories)	Class Settlements, % of ATM notice filings	Individual Settlements, % of individual ATM notice filings
2010	18	6, 33%	3, 18%	9, 50%
2011	16	3, 19%	5, 31%	9, 56%
2012	9	2, 22%	0, 0%	7, 78%

Table 2: ATM Notice Class Action Resolution

As no court scrutiny is required for individual settlements, I do not generally have information about the terms of individual settlements in N.D. Ill. consumer class actions. The only information we found on the docket sheets about awards and attorney fees in cases resolved in favor of individual plaintiffs comes in the form of a default judgment obtained in an ATM notice case entitled *Stilz v. ATM National Solutions, LLC*. In that case, the court entered an order awarding the plaintiff statutory damages of \$1000 and \$10,905.50 in attorneys fees and costs to class counsel. This ratio of attorney fees and costs to plaintiff recovery of 10/1 means of course that in this default judgment case, the attorneys' fees are 1000% of the relief obtained.

As noted above, the requirement that judges approve class settlements as fair does generate information about class settlements. Appendix 1 details the class settlements in ATM notice failure cases. To understand Appendix 1 and the subsequent analysis of class settlements under the other federal consumer protection statutes found in the sample, one must understand a few basic features of class action settlements. In class settlements – not just of ATM notice failures but all class settlements in our sample – there is a stated or nominal settlement amount. In virtually all cases, that nominal amount caps the amount that the defendant pays out pursuant to the settlement. Such payouts go *first* as attorney fees to class counsel, and then as incentive awards to named plaintiffs and as fees to the settlement administrator (the company that sends out notices to the class of their rights under the settlement). Next, actual class members who qualify (typically by filling out a valid claim form) receive compensation. In some cases, provision in the settlement is made for some portion of the remaining funds to be paid out as a cy pres award. In our ND Ill sample, such cy pres awards always went to legal aid organizations of one sort or another. With rare exceptions (in so-called non-reversionary settlement funds), after all these payouts are made, the defendant keeps whatever funds remain from the nominal settlement. Thus, for example, if the nominal settlement amount was \$100,000 but only \$50,000 was paid out to class counsel, named plaintiffs, the class, the settlement administrator, and the cy pres recipient, then the defendant would only pay out a total of \$50,000, not the stated or nominal \$100,000 settlement amount.

The existing empirical literature on class action settlements does not share a common investigative goal and therefore different studies report different class action settlement measures. The most recent such study, by Shepherd,³³ reports on how class settlement payouts are divided among the class, attorneys, settlement administrators and cy pres awards to charities. Fitzpatrick's 2010 paper is concerned primarily with

³³ See supra note ____.

reporting on how attorney fees as a fraction of the nominal payout vary across case types. The CFPB's 2015 study reports on aggregate attorney fees, payouts to the class and compensation rate by product category type.

As my goal here is to focus on evaluating the efficiency of the class action as an instrument of compensation to class members and potential deterrence of harm-causing behaviors, I report on measures of efficiency and compensation. The measure of cost is attorney fees in absolute amount. As measure of compensatory efficiency, I report attorney fees relative both the nominal settlement and actual aggregate payout to the class, and also report the compensation rate, the fraction of the class that actually receives compensation.

As can be seen from Appendix 1, even the nominal class settlements in ATM notice failure class settlements were not large, ranging between \$40,000 and \$150,000. The actual aggregate payout to the class was even smaller, ranging between \$8000 and \$79,000. On average,³⁴ the actual aggregate class recovery – the total amount received by class members -- in the ATM notice failures was only 46% of the nominal settlement amount – the amount that the defendant agreed to pay into a settlement fund. On average, although individual class members who were paid got \$880 each, only 8.5% of the class received any compensation. Attorney fees were another matter. Those averaged 55 percent of the nominal settlement amount but *200 percent* of the actual aggregate payout: that is, class counsel were paid twice the amount actually paid to the class. If we look at aggregate, rather than average numbers, adding up across all ATM notice failure settlements, we find a slightly higher class compensation rate of 10 percent, but with a total payout to all class members of \$169,500 and total attorney fees of \$198,000, even in aggregate, attorney fees were larger than the amount paid to class members.

Despite their relatively small payouts, the ATM notice failure cases are nonetheless very informative about the behavior incentivized when Congress creates statutory causes of action that combine statutory damages without proof of harm with the class action procedural device. In general, that behavior may be aptly described as a feeding frenzy of class action filings where the allegedly illegal behavior literally caused no harm to anyone. That the ATM notice failure cases involved no consumer harm was recognized by Congress itself when in December, 2012, that body voted to eliminate the “on or at notice” ATM notice requirement. As the CFPB noted in its 2013 rulemaking, consumer groups had argued against this deletion on the ground that the “on or at notice” may have been a consumer’s only indication that a fee for ATM use would be charged. Congress in the end agreed with the ATM providers’ commonsensical argument that given that every ATM by then had an on-screen notice of fees, there was no social utility in having another physical notice posted “on or at” the machine. Zero social utility had to be balanced against the facts that not only was it costly for ATM owners to maintain such notices, but the tidal wave of ATM notice litigation was adding to financial institution costs with some of such litigation (at least according to the banking industry) manufactured by plaintiffs who banks believed (but had difficulties proving) had deliberately removed ATM notices just to generate a cause of action.³⁵

³⁴ Unless otherwise noted, only unweighted, numerical averages are reported.

³⁵ See CFPB Amendments to Disclosures at Automated Teller Machines, at 6.

A more specific second lesson from the now extinct ATM notice failure class actions is that class compensation rates in class settlements – the fraction of a class that actually get any money from the settlement – are low sometimes simply because the class actions do not involve big stakes. For small stakes class actions to be economically attractive to class attorneys, courts must ensure that the cost of notifying class members of settlements is sufficiently low. But low cost notice is more often than not ineffective notice. In the case of ATM notice failure settlements, the average compensation rate that was reported was only 8.5 percent.³⁶ The reason why the compensation rate is so low in ATM notice failure class settlements is not because it is technically impossible to determine who used a particular ATM machine on a particular date and give each such person actual notice of their right to share in the settlement. In every one of the settlements in Appendix A, class counsel submitted an affidavit from the same Senior Vice President at a particular bank (First American Bank) explaining that to identify particular people who used a particular ATM on a given day, one could first obtain routing numbers ATM network operators for each transaction, and then using those numbers cross-reference and identify each financial institution that issued the ATM card and, finally, contact that financial institution to get identify each ATM card holder.³⁷ This explanation was given prior to the expert opining on the enormous cost of actually doing this. The court in every ATM notice case then agreed with class counsel that given

³⁶ As Appendix 1 reports, in *Barreto v. Center Bank*, the compensation rate was 5 percent and in *Loewy v. RBS Citizens Bank*, the class compensation rate was 12 percent. The average compensation rate for these two ATM “on or at” notice cases is 8.5 percent, and that is the number reported above in the text. This rate is consistent with what one would infer from the information reported about other ATM “on or at” notice cases. As can be seen from Appendix 1, in several ATM “on or at notice” cases (*Goldshteyn*, *Nguyen* and *Louisma*), class counsel did provide an estimate of the number of allegedly un-noticed ATM transactions. Over the three cases, this number was large, averaging 19,400 for the three cases. To convert the number of ATM transactions into a rough estimate of the number of actual class members, one can divide the total number of transactions challenged by the number of months during which the ATM was allegedly un-noticed and then divide that by an estimate of the number ATM uses per month per user. If we assume that each person using an ATM used that machine on average 5 times per month (a seemingly large number), then we arrive at an estimate of the number of class members of 772 for *Goldshteyn*, 171 for *Nguyen* and 400 in *Louisma*. As 42 class members were compensated in *Goldshteyn*, 75 in *Nguyen* and 44 in *Louisma*, the rough estimate of compensation rates in these three class settlements would be (respectively) 5, 44 and 11 percent. Two of these estimates are almost identical to the actual class compensation rates of 5 and 12 percent in *Barreto* and *Loewy*. The estimated 44 percent compensation rate in *Nguyen* is so much higher than in any other ATM “on or at” notice case that one suspects that the assumption that users of an ATM use the machine on average 5 times per month must be incorrect for the ATM machines at issue in that case. Further evidence that the 8.5 percent class compensation rate in Table 2 may be generally valid for ATM “on or at” notice cases is provided by a report from class counsel in *Barreto* that “as the claim form return rate in consumer class action settlements is known to be between 2 and 20%,” the 5% rate in *Barreto* (a total of 18 claimants) was “well within the average return rate in the consumer class action context.” In addition, class counsel in *Baretto*, reported that “there are usually between 20 and 40 claimants in cases involving one ATM.” Finally, class counsel’s estimate of an ATM “on or at” notice filing rate of between 2 and 20% in consumer class actions comes was drawn from an article written by a claims administrator with Rust Consulting.³⁶ The full statement by that claims administrator reads as follows: “With their broad range of subject matter, benefit types and amounts, and class member demographics, as well as the ‘hit-or-miss’ availability of mailing lists, consumer settlements can draw a filing rate between two and 20 percent.”

³⁷ See, for example, the affidavit of Eduardo Monteagudo, the bank vice president mentioned in the text, which appears as Exhibit D to class counsel’s memorandum in support of final approval of the class action settlement, Docket No. 55 in *Goldshteyn*.

the enormous cost of actual individual notice, notice to the class could be given via a general public newspaper notice and a website.

As indicated by the low compensation rate, such public notice was glaringly ineffective in actually communicating to members of ATM notice failure classes that they had a right to share in the recovery. District courts approved such a notice method because given the small stakes in these cases, actual individualized notice would have been cost prohibitive. In other words, for ATM notice class action settlements to really communicate to class members that they had a right to compensation, such class actions would have cost far more than the maximum expected recovery and so would not have been brought; attorneys would bring such cases only if cheap but ineffective notice to class members was all that was required when class settlements were achieved. This basic class action dilemma is clearly depicted by the ATM notice failure settlements.

While as cautioned at the outset, I have not attempted to confirm the representativeness of the ND Ill sample, it is worth noting that compensation rates in my N.D. Ill. sample seem likely to be typical of rates in ATM “on or at” notice failure cases more generally. We have some sense of what payout rates are typically like in ATM EFTA notice failure cases nationwide because of information supplied by class counsel in cases in our sample. This information is found in the memoranda that class counsel submit in support of their motions for judicial approval of the class settlements. In *Barreto v. Center Bank*,³⁸ a class action alleging an EFTA ATM notice violation, counsel reported that 5% of the settlement class received compensation under the settlement. In their memorandum in support of final approval of the settlement, class counsel furthermore reported³⁹ that as the claim form return rate in consumer class action settlements is known to be between 2 and 20%, the 5% rate in *Barreto* (a total of 18 claimants) was “well within the average return rate in the consumer class action context.” In addition, class counsel in *Barreto*,⁴⁰ reported that “there are usually between 20 and 40 claimants in cases involving one ATM.” The claim filing rate of between 2 and 20% in consumer class actions, comes from an article written by a claims administrator with Rust Consulting.⁴¹ That settlement administrator reports that: “With their broad range of subject matter, benefit types and amounts, and class member demographics, as well as the “hit-or-miss” availability of mailing lists, consumer settlements can draw a filing rate between two and 20 percent.”

The final lesson from the ATM notice failure cases is that even in such seemingly simple cases, defendants will not settle until they exhaust every legally plausible defense whose cost is low relative to the stakes. Indeed, evolution of the potential legal defenses to ATM notice failure cases explains the evolution in outcomes in such cases over the 2010-2012 period. During 2010, defendants won fully a third of the ATM notice cases by making an offer of judgment to the named plaintiff and then moving to dismiss the case as moot. This tactic – buying out the named plaintiff and therefore mooting the class

³⁸ 10-cv-06554 (N.D. Ill. 2010)

³⁹ In the memorandum in support of final approval of the class action settlement.

⁴⁰ Appendix A, p. 5, Exhibit ___ to Plaintiff’s Supplemental Memorandum in Support of Final Approval of the Parties’ Class Action Settlement Agreement.

⁴¹ Tiffany Allen, Anticipating Claims Filing Rates in Class Action Settlements, November, 2008 available at http://www.rustconsulting.com/Knowledge_Sharing/Articles_and_Publications/ID/124/Anticipating_Claims_Filing_Rates_in_Class_Action_Settlements.

action – was possible because under then-recent Seventh Circuit precedent, *Damasco v. Clearwire Corp.*,⁴² once the defendant “offers to satisfy the plaintiff’s entire demand, there is no dispute over which to litigate, and a plaintiff who refuses to acknowledge this loses outright, under Fed.R.Civ.Pro. 12(b)(1) because there he has no remaining stake.” As the plaintiff in *Clearwire* pointed out, other circuits had created a rule that allows named class plaintiffs to avoid mootness by expeditiously moving to certify the class even after being offered complete relief.⁴³ The Seventh Circuit held that such an exception to mootness in class actions was unnecessary, because class counsel could move to certify the class at the same time they file their complaints, requesting also for the court to delay ruling on the motion to certify the class until time is allowed for discovery on the class certification issue.

In 2010, many of the ATM notice class actions were lost by plaintiffs. Some of these cases were lost because the defendant was able to establish the affirmative defense that it had posted the notice as required but the notice was removed either by a third party or through no fault of the defendants. Most, however, were lost because defendants made offers of full judgment before plaintiffs had requested class certification, thus mooting these cases under the Seventh Circuit’s *Clearwire* decision. However, as one can discern from the pleadings, by 2011, class counsel had learned how to deal with the mootness problem by filing motions for class certification early on, or telling the court that they were going to do so. And they had become better at proving notice violations – by taking photos of ATM machines over a several day period prior to the date when named plaintiffs tried to use and un-noticed ATM. Once class counsel figured out how to avoid mootness and the statutory affirmative defenses, ATM notice class actions succeeded almost always in generating some kind of settlement for the individual plaintiff and/or the class he or she represented: 92% of the cases filed in 2011 resulted in a settlement, and 83% of the cases filed in 2012 resulted in a settlement.

Admittedly, as we see from Table 1, the type of settlement was radically different between cases filed in 2011 and those filed in 2012: while in 2011, 38% of the ATM notice class action settlements resulted in class settlements, in 2012, there were no class settlements but only individual settlements in this case type. The reason undoubtedly is that by the time the 2012 cases reached the point where settlement discussions could begin – generally toward the latter part of 2011 or sometime during 2012 – all parties recognized that Congress was soon to amend the statute to eliminate the basis of the cause of action for all future cases.

B. Class Actions under the Other Major Federal Consumer Protection Statutes

The ATM notice class actions under EFTA are now extinct, but consumer class actions survive across the country under the FCRA, FDCPA and TCPA. As illustrated by Figure 2 (reproducing graphically the data from Table 1 above), the frequency of various outcomes differ across these case types. In particular, the distribution of outcomes under the FDCPA involves a much higher probability of an individual settlement (and hence overall settlement rate) than occurs under both the TCPA and FCRA. As a statistical matter, the difference between the outcome distribution under the FDCPA is significantly

⁴² 662 F.3d 891, 895 (7th Cir. 2011)(quoting *Rand v. Monsanto Co.*, 926 F.2d 596, 598 (7th Cir. 1991)).

⁴³ *Clearwire*, 662 F.3d at 895-896.

different than the outcome distribution under both the FCRA⁴⁴ and under the TCPA.⁴⁵ The qualitative discussion of outcomes under these various statutes that follows below sets out some potential explanations for the distinctiveness of FDCPA outcomes.

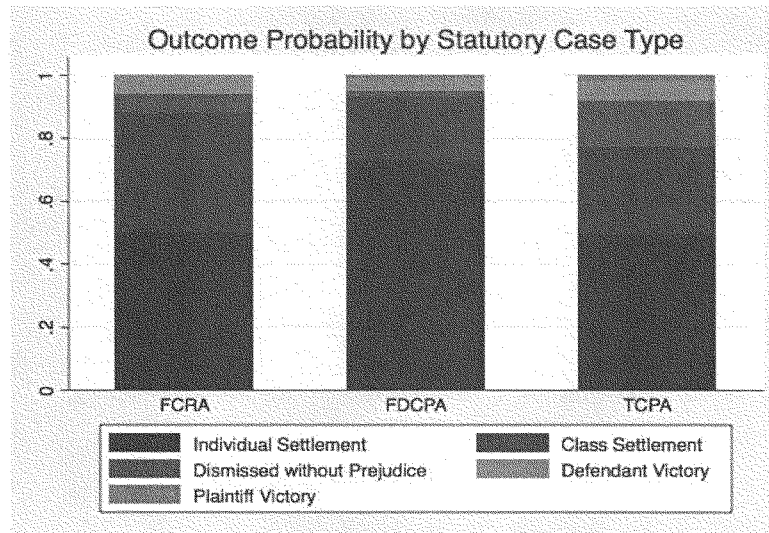


Figure 2. Outcome Probability by Statutory Case Type

I begin with FCRA, a statute that has created the same sort of problem found in the old ATM notice failure cases: a feeding frenzy of filings of cases with easy to prove statutory violations, injury-free statutory damage rights, and no harm to anybody.

1. The Fair Credit Reporting Act

Passed in 1970, in the heyday of federal consumer protection legislation, FCRA⁴⁶ was intended to ensure that the information in the files of consumer reporting agencies was both accurate and kept private, to be used only for certain authorized purposes. FCRA imposes potential liability on both users of consumer credit reports and providers of such reports. Under FCRA, employment background checks are included within the regulated category of “consumer reports.” An employer who uses such a report in its hiring decisions is thus regulated under FCRA as a user of a consumer report. FCRA requires that an employer comply with several procedural steps in using an employment

⁴⁴ With the FDCPA distribution taken as the null, $F(4, n) = 15$, allowing one to reject the hypothesis of identical distributions with $p < .01$.

⁴⁵ Again with the FDCPA distribution taken as the null, $F(4, n) = 121$, which allows one to reject the hypothesis of identical distributions with $p < .001$.

⁴⁶ Found at 15 U.S.C. § 1681 et seq.

background check.⁴⁷ First, the employer must tell the prospective employee that it might use the information in the report in an employment decision and it must ask the employee for written permission before getting the report. Once the employer gets the report, if the employer thinks the report might influence its decision, then it must give the prospective employee a copy of a standard “Summary of Rights” produced by the Federal Trade Commission. If the employer bases a decision on something in the report – such as criminal or credit history – then it must give the prospective employee contact information about the company that provided the report along with an explanation that this company didn’t take the actual employment decision and won’t be able to explain it, and, finally, an opportunity for the prospective employee to dispute the information in the report before taking action based on it.⁴⁸ If the employer takes an adverse action based on the background report, then it must send the applicant notice of this within a reasonable time.

In 2003 FACRA was amended by the passage of FACTA (the “Fair and Accurate Credit Transactions Act”). Intended to better ensure consumer privacy and standardized reporting, FACTA did two things of relevance to the class action filings in our dataset. First, it added a liability provision under which a if successful in establishing a “willful” FCRA violation, consumers may recover attorneys’ fees, costs and punitive damages and also statutory damages of between \$100 and \$1000 without need to prove actual injury. To recover for a negligent violation of FACTA, a consumer must prove actual damages but may also recover attorneys’ fees and costs.⁴⁹ Second, as one of its privacy protection provisions, FACTA regulated credit card receipts issued by retail merchants, providing that “no person that accepts credit cards or debit cards for the transaction of business shall print more than the last 5 digits of the card number or the expiration date upon any receipt provided to the cardholder at the point of sale or transaction.”⁵⁰

Much early litigation under FACTA involved the question of whether defendants who claimed to be unaware of the statutory requirement to remove expiration dates from receipts could nonetheless be held liable for a “willful” violation of that law. Federal courts had come up with various standards for FACTA willfulness, and in its 2007 *Safeco* decision the Supreme Court only partially clarified matters when it stated that FCRA (and therefore FACTA) willfulness meant an objective “reckless disregard” standard but stated also that “the negligence/recklessness line need not be pinpointed here.”⁵¹ Hundreds of FACTA class actions were filed after *Safeco*. Class counsel arguing that the discovery cost of determining what a business knew or didn’t know about its receipts would only be economically feasible if class recovery could be obtained. Businesses argued that the potential for crushing billion-dollar class action liability for technical FACTA violations that had not caused any harm to consumers cautioned strongly against certification of such FACTA class actions.⁵²

⁴⁷ See Federal Trade Commission, Employment Background Checks, November 2014, available at <https://www.consumer.ftc.gov/articles/0157-employment-background-checks>.

⁴⁸ [relevant statutory provisions]

⁴⁹ 15 U.S.C. §§1681n, 1681o.

⁵⁰ 15 U.S.C. §1681c.

⁵¹ *Safeco v. Burr*, 127 U.S. 2201, 2204 (2007).

⁵² See Bruce L. McDonald, Congress Restricts FACTA Statutory Damage Class Actions, available at [finish cite]

By 2008, Congress amended FACTA by passing the “Credit and Debit Card Receipt Clarification Act.”⁵³ According to Congress, this law was prompted by the “hundreds of lawsuits” filed against merchants who had mistakenly believed that FACTA compliance required them only by truncating the credit card number and not the expiration date.⁵⁴ Congress found specifically that “experts in the field agree that proper truncation of the card number...regardless of the inclusion of the expiration date, prevents a potential fraudster from perpetrating identify theft or credit card fraud.”⁵⁵ As it “deemed these lawsuits to be a significant burden on businesses, without any corresponding consumer benefit,” Congress retroactively shielded from FACTA liability for statutory damages for a willful violation any merchant who between December 4, 2004 and June 3, 2008 had printed an expiration date on a receipt but who otherwise had complied with FACTA by truncating the credit card number.⁵⁶ Despite its finding that printing an expiration date alone did not increase the risk of credit card fraud, Congress retained potential FACTA willful violation liability for statutory damages for such an error on any receipt printed after June 3, 2008.

Our data confirm the general perception that there continue to be a flood of class action filings for violations of FCRA’s employment background check procedural requirements and for violating FACTA by printing a credit card expiration date on the receipt. Of the 53 FCRA class actions filed over 2010-2012 in the ND Ill, 27 (51 percent) alleged that a card expiration date was illegally printed on a receipt and 17 (32 percent) alleged a failure to follow FCRA employment background check procedures. The remaining 9 (or 17 percent) of FCRA filings alleged an actual breach of privacy by the release of personally identifying information by a merchant. However, of the 19 class settlements of FCRA cases, only 1 settlement involved the release of personally identifying information, with 11 (58 percent) and 7 (37 percent) coming in expiration date and employment background check cases respectively.

Viewing FCRA class settlements in aggregate, attorneys fees of \$3,816,535 were incurred to generate \$6,056,909 in aggregate payouts to class members. Thus compared with ATM notice failures, at least aggregate attorney fees were less than the amount paid to class members. Also, FCRA cases involved much bigger settlements, with an average settlement class of 45,715, an average nominal settlement of \$775,645, and an aggregate payout of \$413,052. Thus in FCRA class settlements the actual aggregate payout to class members averaged only 37 percent of the nominal settlement amount. Attorney fees averaged \$185,803. It takes on average about 13 months from the case filing date for such settlements to receive final judicial approval.

The high frequency⁵⁷ and quite rapid finalization of class settlements in expiration date and employment background check FCRA class actions undoubtedly reflects the fact that such violations are easy to prove. Like the ATM “on or at” notice cases, both the FACTA expiration date and the employment background report cases were the opposite

⁵³ Public Law 110-241, 122 Stat. 1565 (2008).

⁵⁴ Clarification Act §2(a)(4).

⁵⁵ Clarification Act §2(a)(5)-(6), 122 Stat. at 1565.

⁵⁶ Long v. Tommy Hilfiger U.S.A., Inc., 671 F3d 371, 374 (3rd Cir. 2012), citing Clarification Act §§2(a)(7), 1122 Stat. at 1565-66 and §3(a), 15 U.S.C. §1681n(d), 122 Stat. at 1566.

⁵⁷ [Evaluations of the statistical significance of class settlements across case types will be based on multinomial logit regressions that will be run by the GMU workshop date]

of frivolous;⁵⁸ the FCRA violation in them seemed clear and was easily evidenced by the receipt (in expiration date cases), or by the failure of the applicant to be given the required notices and reports (in the employment report cases). And in both case types, the “willfulness” standard for the award of statutory, no injury damages has proven to be easy for class counsel to meet. Through countless websites and blogs, attorneys and regulators have themselves created sufficient general awareness of FCRA’s requirements to establish statutory willfulness. For example, even by 2010, plaintiffs in FACTA expiration date class actions routinely alleged that the willfulness requirement was met because credit card companies advised and contractually required merchants to truncate expiration dates, with such truncation also required by international consumer protection conventions.⁵⁹ Defendants argued that such allegations were mere boilerplate, contained in every FACTA expiration date complaint, and that they did not establish recklessness as required by Supreme Court interpretations of FACTA.⁶⁰ Such arguments, made on 12(b)(6) motions to dismiss, were rarely ruled upon. Instead, at an identical mean time to settlement of 13 months, both FCRA expiration date and background report class settlements were reached very quickly. This suggests that the FACTA willfulness requirement has in practice provided very little protection for businesses under FACTA and that like the ATM “on or at” notice cases, FACTA expiration date cases represent a relatively easy payday for class counsel.

Perhaps the most important respect in which the FCRA expiration date and employment background report cases are like the ATM “on or at” notice cases is that neither type of violation involves any actual injury to a plaintiff. As for the expiration date cases, Congress specifically found in 2008 that experts did not believe the risk of credit card fraud is not increased when a merchant prints out the expiration date but truncates the actual credit card number as FACTA requires. Plaintiffs in FACTA expiration date cases do not allege that they have suffered harm, but seek statutory damages for willful violations. Federal courts who have found standing for plaintiffs alleging such FACTA violations have reasoned that the mere statutory violation itself can establish “injury” sufficient to meet constitutional standing requirements.⁶¹ And the injury in employment background reports – a failure to follow process – is precisely the type that at least in the constitutional standing area the U.S. Supreme Court has found not to constitute an actionable injury.

In some other important respects, the two main types of FCRA class settlements differ significantly. As shown in Figure 3, the 37 percent class compensation rate in employment report class settlements is almost three times the 14 percent compensation rate in expiration date cases. Because of this, aggregate compensation in employment report cases is roughly equal to the nominal settlement amount and, as Figure 4 shows, attorney fees in such cases are on average about 42 percent of both the nominal settlement and the aggregate payout. As Figure 4 also shows, this is far from true for

⁵⁸ Indeed, only 7 such cases ended in dismissal and only two of these dismissals were with prejudice; at least one of these two may have been an individual settlement.

⁵⁹ An example is provided by the discussion in the defendant’s motion to dismiss for failure to state a claim in *Redman v. Take Care Health Systems, LLC*, Case No. 11-cv-09044, Docket No. 22 (filed March 19, 2012).

⁶⁰ [add discussion of *Safeco* and subsequent decisions]

⁶¹ See, e.g., *Hammer v. Sam’s Club East*, No. 12-3724, 8th Cir. June 5, 2014.

expiration date class settlements, where (as can be inferred directly from Figure 4), on average the aggregate compensation to class members is only 6 percent of the nominal settlement. As for attorneys fees, as Figure 4 shows, at a mean level of 895% of the aggregate payout to the class, attorneys fees relative to the aggregate payout to the class are by (a highly statistically significant, $F(1) = 3.35$, $p < .0001$) order of magnitude higher in expiration date cases than in other FCRA class settlements.

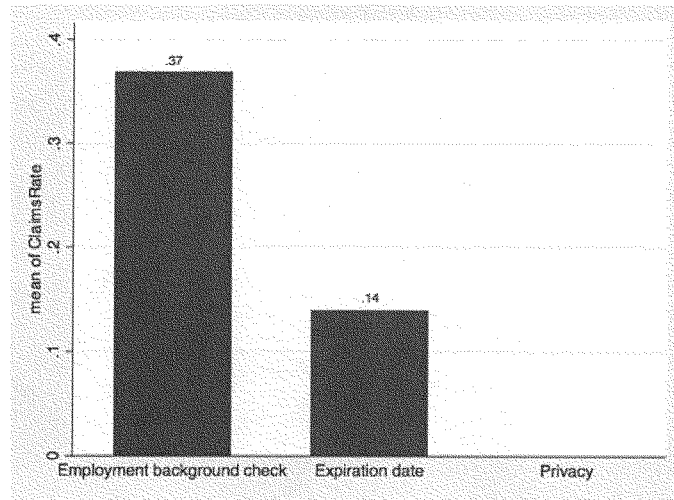


Figure 3. FCRA Mean Compensation Rate by Case Types

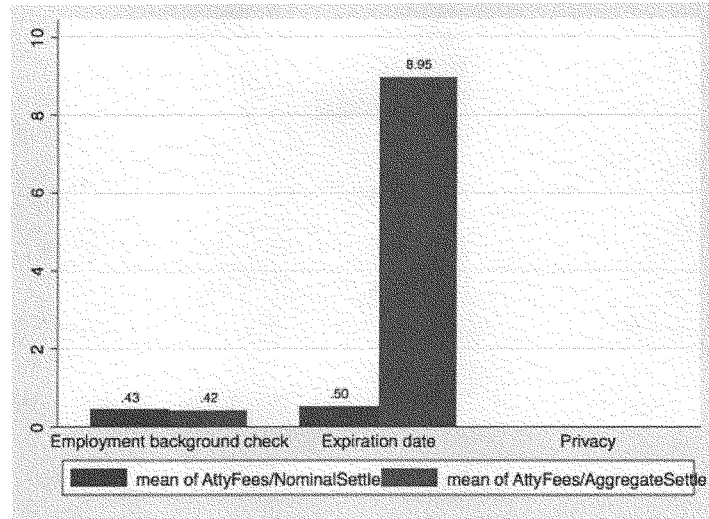


Figure 4. FCRA Attorneys Fees as Fraction of Nominal and Aggregate Settlement Amounts by Case Type

Further confirmation of the vast difference between class settlements in employment report FCRA cases and expiration date cases is provided by Table 3 below. As it reports, in a simple linear regression of the claims rate on a number of potential explanatory variables, only the case type was a statistically significant predictor of the claims rate. The FCRA expiration date class action settlements have a highly statistically significant and much lower (42 percent lower than the average) claims rate.

Claims Rate	Coef.	Std. Err.	T	P>t	[95% Conf.	Interval]
Duration	-.0078911	.0114538	-0.69	0.510	-.0343036	.0185213
Class Size	-1.08e-06	1.29e-06	-0.83	0.428	-4.07e-06	1.91e-06
Aggregate Payout	-1.84e-07	2.39e-07	-0.77	0.464	-7.36e-07	3.68e-07
IndividualCompensation	-.0002402	.0002407	-1.00	0.347	-.0007953	.0003148
Nominal Settlement	9.53e-08	1.72e-07	0.55	0.595	-3.02e-07	4.92e-07
FCRA Expiration Date	-.4220977	.1558508	-2.71	0.027	-.7814903	-.0627051
Constant (other case type)	.6489319	.2298145	2.82	0.022	.1189788	1.178885

Table 3. Regression Results for FCRA Class Settlement Compensation Rate

2. The Fair Debt Collection Practices Act

The most numerous class action filing in our dataset was one under the Fair Debt Collection Practices Act (FDCPA). Another of the core vintage 1970 federal consumer protection statutes, the FDCPA was intended to stop various debt collection practices that Congress had found to be abusive to consumers. Successful FDCPA plaintiffs are entitled to a broad range of compensatory damages, including damages not only for lost wages but also for physical and mental distress, and statutory damages without proof of harm up to \$1000 in each suit.⁶² In a class action, FDCPA limits statutory damages recovered on behalf of absent class members to the lesser of \$500,00 or 1 percent of the debt collector's net worth.⁶³ The FDCPA, as amended, includes six main sections that prohibit a variety of actions by debt collectors. Our FDCPA filings can be categorized into several functional categories that cut across these statutory provisions.

i) Formality Failure

The FDCPA imposes a number of formal, disclosure requirements on debt collectors. Cases alleging a failure to follow one or more of these formalities are the most numerically important in our data, making up fully 50 percent of all FDCPA filings (71 out of 141⁶⁴). Formality failures fall into three distinct sub-categories. The first type, phone identification, describes cases in which a debt collector did not properly identify himself or herself as such when contacting the debtor.⁶⁵ These cases often involved debt collectors leaving phone messages asking the consumer to call back without giving the necessary warning.

The second type of FDCPA formality failure, a letter notice, describes cases in which a debt collector sent a letter notice to the consumer that violated the requirements for a letter notice stated in 15 U.S.C. §1692g. Typical examples of this subcategory were letter notices that did not provide effective notice of the 30-day verification period; letter notices that failed to effectively identify the name of the creditor; failures to include that any dispute or request for name of the original creditor must be in writing; and failures to include the principal and interest amounts (only states the total amount due).

The third subcategory of FDCPA formality violations, which we call state law, describes cases in which a debt collector violated a state law requirement. The main instance of this violation occurred when a party attempted to collect debt without being properly licensed as a collection agency in the state of Illinois.⁶⁶

ii) Bad Debt

Numerically the second most important type of FDCPA filing in our database (39 of 141 or 28 percent), we identified three sub-categories of bad debt FDCPA cases. The first, bad debt interest, describes cases in which a party impermissibly added interest.

⁶² [add cite to damages section]

⁶³ 15 U.S.C. §1692k(a)(2)(B).

⁶⁴ The denominator is larger than the number of actual FDCPA filings because 10 FDCPA cases included alleged violations in several categories.

⁶⁵ The failure by a debt collector to disclose in the initial communication with the consumer that he or she is a debt collector, and that the debt collector is attempting to collect a debt, and any information gathered in the communication will be used for that purpose, is in violation of 15 U.S.C. §1692e.

⁶⁶ These cases alleged that engaging in this action constituted a false, deceptive, or misleading representation or means in connection with the collection of any debt under 15 U.S.C. §1692e.

Specifically, these cases often involved a party who purchased debt and retroactively added interest to the amount owed before the time the party purchased the debt despite the original creditor's refusal to do so.⁶⁷ The second subcategory of bad debt filing, time-barred, refers to cases in which a debt collector attempted to collect a debt after the date at which it no longer was collectable.⁶⁸

The last bad debt subcategory, bad affidavit, describes cases in which a fraudulent affidavit was provided to consumers in violation of 15 U.S.C. §1692e. In several cases, the fraudulent affidavits effectively represented to consumers that the party attempting to collect the debt could prove the debt, when they could not. Additionally, these affidavits would do so while the party was concealing documents from its purchase of the debt containing express disclaimers about the enforceability and validity of the debts ("as is" clauses). Other cases involving fraudulent affidavits include the impermissible modification of an affidavit after affiant signed it.

iii) Litigation Threat

A relatively small fraction (7 out of 141 or 5 percent) were based on an alleged threat by the debt collector that it would take legal action against the consumer if the debt was not paid off, in spite of the fact that legal action would not be taken. Oftentimes, these cases involved debt collectors who routinely do not file suit to collect on small debts, yet represented to the consumer that they would do so in their particular case, even though it was a small debt. Under 15 U.S.C. §1692e, a debt collector may not use any false, deceptive, or misleading representation or means in connection with the collection of any debt. This includes the threat to take any action that cannot legally be taken or that is not intended to be taken.

iv) Harassment

The final FDCPA category that we created, called harassment, includes cases alleging egregious behavior by the party attempting to collect the debt. For example, a debt collector would repeatedly and continuously call a consumer without prior authorization to do so and with intent to annoy, abuse, or harass, attempt to embarrass the consumer by calling third parties related to the consumer in attempt to collect the debt, often using inappropriate methods such as auto-dial and pre-recorded messages. Some of these cases involved debts the consumer did not owe.⁶⁹ There were 16 cases in the harassment category (11 percent of all FDCPA filings).

Two cases that did not appear to fall under any of the previous four categories were placed in the "other" category. These included a case in which the debt collector reported false information about the debt to consumer reporting agencies, and a case in

⁶⁷ The FDCPA prohibits the use of 'unfair or unconscionable means to collect or attempt to collect any debt,' under 15 U.S.C. § 1692f, including '[t]he collection of any amount (including any interest, fee, charge, or expense incidental to the principal obligation) unless such amount is expressly authorized by the agreement creating the debt or permitted by law.' As such, any addition of interest to the debt outside of the original agreement creating the debt is a possible violation.

⁶⁸ Under 15 U.S.C. §1692f, the FDCPA prohibits a debt collector from using any unfair or unconscionable means to collect or attempt to collect a debt. Attempting to collect a debt that is time-barred, or, in the alternative, wrongly indicating that a debt is time-barred, is an unfair or unconscionable means to collect a debt.

⁶⁹ These attempts may be in violation of 15 U.S.C. §1692b, c, d, and e.

which a party purchased healthcare debts and then purported that payments on those debts constituted acceptance of a revolving credit line from that party.

As can be seen from Figure 5 below, class settlements by FDCPA case type closely track the filings sample proportions with filings/class settlement proportions being 51/54 percent for formalities, 23/28 percent for bad debt, the two main case types. At 15 versus 5 percent, only for litigation threat type cases was the class settlement proportion far above the proportion of filings.

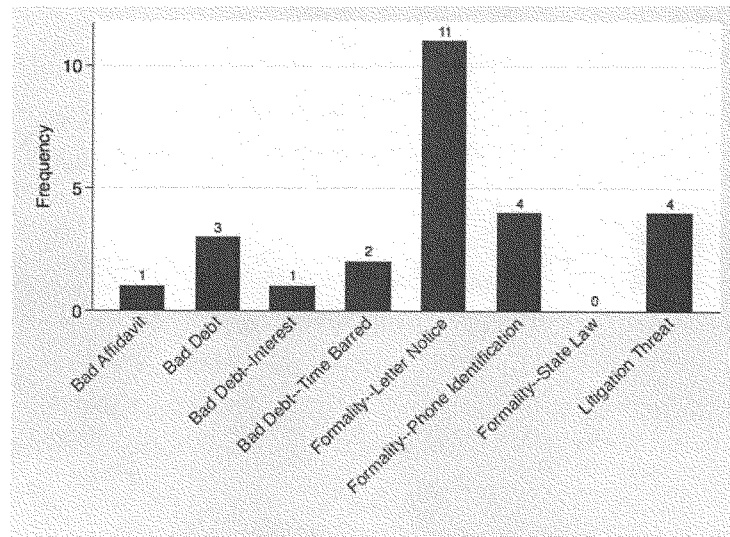


Figure 5. FDCPA Class Settlements by Case Type

In aggregate, attorney fees of \$787,525 were incurred to generate a FDCPA class settlement payouts of \$1,365,662. On average, FDCPA are small class action settlements for small classes, with an average class size of 4882, an average nominal settlement of \$58,724, and average attorney fees of \$31,500. The small size of even nominal settlements reflects partly the small number of class members, but also the FDCPA's statutory limitation on statutory damages in class action cases. These settlements take some time to achieve, on average not receiving final judicial approval until 17 months after the case filing date. The mean aggregate payout to the class in FDCPA class settlements is \$54,626, a full 88 percent of the nominal settlement. Moreover, on unweighted average, 25 percent of the class receives compensation in a FDCPA class settlement.

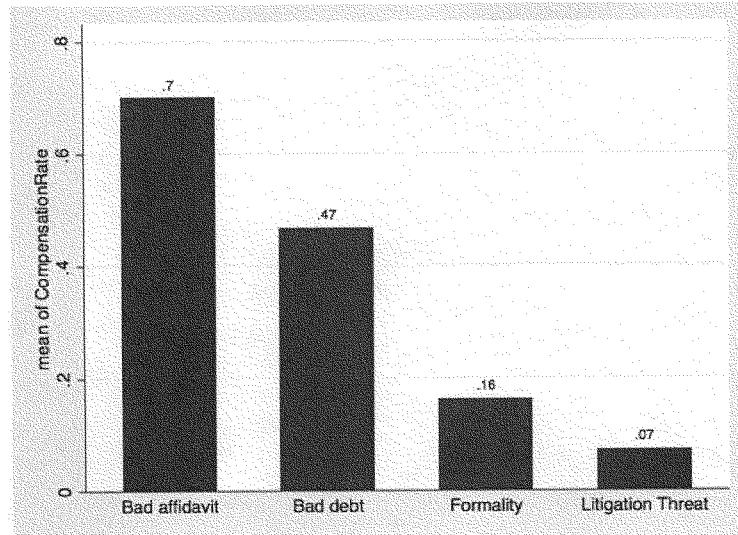


Figure 5. FDCPA Claims Rates by Case Types

As Figure 5 shows, the mean compensation rate in FDCPA cases varies by an order of magnitude across case types, from 7 percent for the three cases alleging unlawful litigation threats to 70 percent for the case alleging a bad affidavit. Restricting attention to the two most frequent FDCPA settlement types, those alleging a failure of the debt collector to follow a required formality, and those alleging attempts to collect on a bad debt, the mean compensation rate varies from 47 percent for the bad debt settlements to 16 percent for the formality settlements. The difference in the compensation rate across case types is statistically significant (with $F(3,21) = 9.8$, $p < .007$).

Unlike compensation rates, attorneys fees relative to the nominal class settlement amounts and aggregate payouts do not vary as much across FDCPA case types. As an average, attorney fees for all types of FDCPA settlements are at least 62 percent of the nominal settlement and 64 percent of the actual aggregate payout to the class (and the two rates are almost identical because 88 percent of FDCPA nominal settlements are paid out to the class). On the other hand, on average fees never exceed the actual aggregate amount paid to the class. This is because, as noted earlier, in FDCPA cases, the actual aggregate payout to the class is typically quite near the nominal settlement amount.

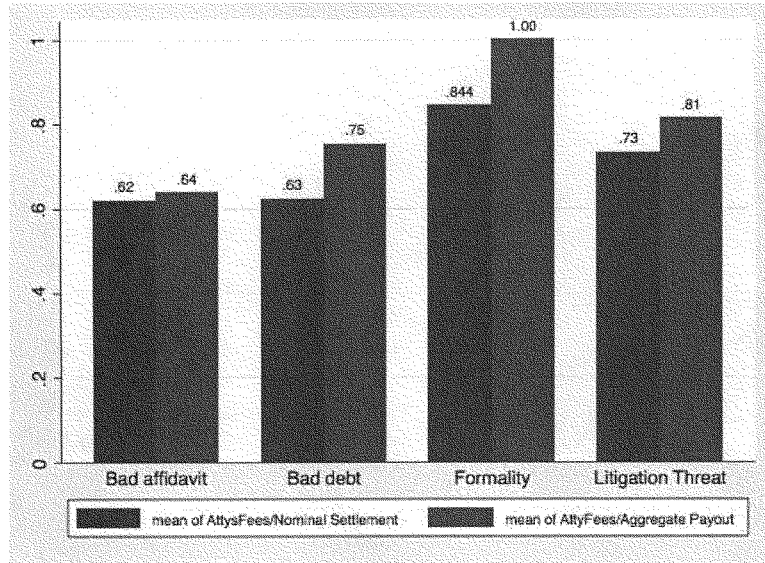


Figure 6. FDCPA Attorneys Fees as Fraction of Nominal Settlement Amount and Actual Aggregate Compensation Paid to Class Members

3. Telephone Consumer Protection Act

The Telephone Consumer Protection Act prohibits the sending of autodialed telephone calls, faxes and emails to which the recipient has not consented -- so-called junk voicemails, faxes, and emails.⁷⁰ Such communications are allowed under the TCPA only if the recipient voluntarily gave the sender her phone number within the context of already an established business relationship between the sender and recipient (or the recipient published its fax number on an internet site). Importantly, like all the other federal consumer protection statutes discussed in this article, the TCPA allows class action plaintiffs to claim either actual damages or statutory damages of \$500 without proof of injury. The TCPA gives the trial court the discretion to treble those statutory

⁷⁰ With exceptions discussed below, the TCPA makes it unlawful to “make any unauthorized call using any automatic telephone dialing system or an artificial or prerecorded voice ... to any telephone number assigned to a paging service, cellular telephone service, specialized mobile radio service, or other radio common carrier service, or any service for which the called party is charged for the call;... to initiate any telephone call to any residential telephone line using an artificial or prerecorded voice to deliver a message without the prior express consent of the called party,...[and to] to use any telephone facsimile machine, computer, or other device to send, to a telephone facsimile machine, an unsolicited advertisement.” 42 U.S.C. §227(b)(1).

damages, to \$1500 per violation, when it has been found that the defendant “willfully or knowingly” violated the statute. Importantly, under the TCPA, however, statutory damages are per violation.

Unlike the other statutory causes of action studied here, because TCPA damages aggregate across thousands and in some cases millions of unconsented autodialed communications, TCPA class actions are often huge. On average, there were 1,901,402 class members in the TCPA class action settlements in our sample. TCPA settlements on average produce a nominal settlement of \$7,377,495, and an aggregate payout of \$6,293,547 (or 68 percent of the average nominal settlement). Attorney fees average \$2,225,213, but it takes on average 26 months from the case filing date for such settlements and fees to receive final judicial approval. Moreover, the unweighted average compensation rate in TCPA settlements is only 19 percent. As far as the aggregate performance goes, TCPA class actions look pretty good, with attorneys fees of \$76,945,118.49 incurred to generate nominal settlements totaling \$223,032, 294 and actual aggregate payouts of \$181,964,180.

The TCPA cases fall into three broad case types: those involving autodialed phone calls (or, less often, a text) made as part of the debt collection process (42 percent of all TCPA filings), those where an unauthorized marketing fax was sent (31 percent of all filings), and those with a marketing text, call or email was sent (27 percent of all filings). When it comes to class settlements, however, at 44 percent each, debt call and marketing fax case types account for the vast majority of TCPA class settlements (with marketing call, text or email cases making up the remainder of class settlements).

Debt call and marketing fax class settlements are at opposite ends of the TCPA spectrum. Of the marketing fax class settlements, 87 percent involved doctor’s and dentists offices or other businesses who received unsolicited telemarketing faxes. Class settlements in marketing fax cases involved moderately large to small classes averaging 14,717 members. As can be seen from Figure 7, at .26, such settlements had by far the highest class compensation rate among all TCPA class settlement types.

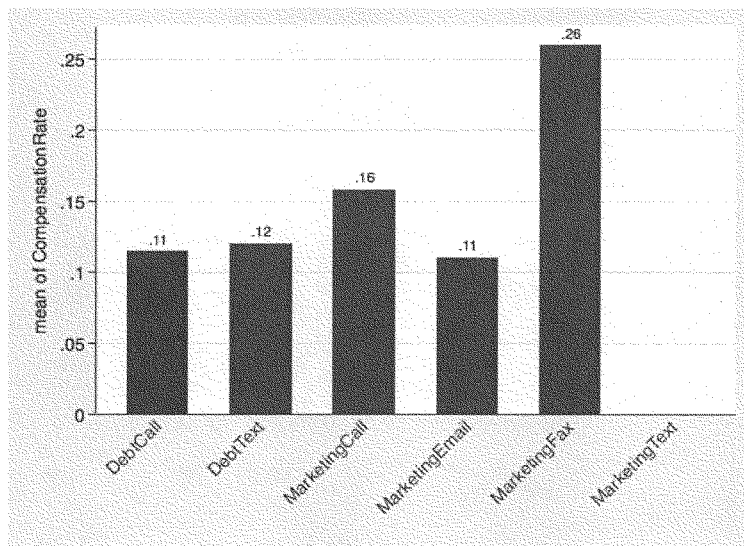


Figure 7. TCPA Class Compensation Rates by Case Type

This is confirmed by Table 4 below. That table reports regression analysis of the class compensation rate on other TCPA settlement variables. It shows that although none of the explanatory variables considered had a (standard, .05) statistically significant role in explaining the compensation rate, whether or not the case alleged an illegal marketing fax did approach such significance.

Compensation Rate	Coef.	Std. Err.	T	P>t	[95% Conf. Interval]
AttyFees	6.54e-08	8.83e-08	0.74	0.468	-1.19e-07 2.50e-07
ClassSize	-1.00e-08	3.03e-08	-0.33	0.744	-7.35e-08 5.34e-08
NominalSettle	-2.44e-08	4.69e-08	-0.52	0.609	-1.22e-07 7.37e-08
AggSettle	1.10e-08	3.01e-08	0.37	0.718	-5.20e-08 7.41e-08
Payout per Class member	-.0001174	.0001598	-0.73	0.472	-.0004518 .0002171
Debtcalldummy	.0146163	.1632769	0.09	0.930	-.3271261 .3563587
MarketFaxdummy	.183703	.1630973	1.13	0.274	-.1576635 .5250695
Constant	.1217326	.1512026	0.81	0.431	-.194738 .4382033

Table 4. Regression Results for TCPA Compensation Rate

It must be recalled that these are unweighted compensation rates. If we look at the (smoothed) distribution of the claims rate across all TCPA case subtypes, then as depicted in Figure 9 below, we see that the distribution is highly skewed, with most

settlements involving a claims rate of less than 20 percent. If we compute the compensation rate weighted by the relative class size compensated, we find that the weighted compensation rate in TCPA debt call class settlements is only .04, or 4 percent. The weighted compensation rate in TCPA marketing fax settlements is .21, or 21 percent.

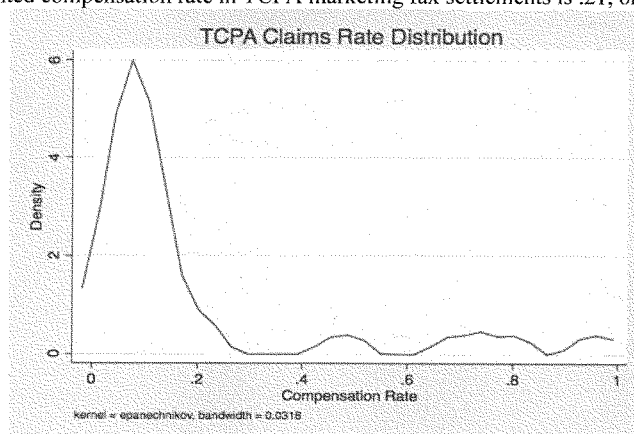


Figure 9

This vast difference in compensation rate likely reflects several differences between debt call and marketing fax class settlements. One is sheer size, with several TCPA debt call settlements involving classes with tens of millions of members and an average class size of 5,905,313, while marketing fax classes are smaller, averaging 22,090 members.⁷¹ Another difference goes to the type of defendant. TCPA unauthorized telemarketing fax settlements sometimes involve large national corporate defendants (such as Interline Brands, a direct marketer), but generally involved smaller firms (such as Global Healthcare Resources, which recruits and places foreign nurses). TCPA debt call settlements, by contrast, were more often than not made with very large financial institution defendants, including J.P. Morgan Chase, Capital One, Fifth Third Bank, and General Motors Financial. In debt call class settlements, the mean aggregate payout to the class ents was \$12,156,263, almost six times larger than the mean aggregate payout of \$2,255,563 in all other TCPA class settlements (a difference that with $F(1,26) = 3.26$ has $p < .08$). The average individual payout to class members actually receiving compensation in TCPA debt call settlements was at least⁷² \$289.

The average compensation to class members paid was at least \$453 dollars each in marketing fax settlements, and in this light the average individual payout in debt call settlements may seem reasonable. However, it must be stressed that this is an

⁷¹ There were 70,863,754 class members in debt call settlements and 309,260 class members in marketing fax settlements [counting Martin and Patterson as separate settlements]

⁷² This is the minimum because in some settlements, only the amount paid per fax was reported in the settlement, making it possible that some class members may have received compensation for multiple unsolicited faxes.

unweighted average. Two of the class settlements in my sample, in *Patterson v. Capital Management* and *Martin v. Leading Edge Recovery Solutions, Inc.*, were part of the settlement of the multidistrict litigation in *In Re Capital One*. That litigation included almost half of all class members in my sample (17,522,049), and there the individual payout to members actually receiving compensation was only \$40. Moreover, in the largest TCPA class settlement, *Gehrich v. J.P. Morgan Chase Bank*, with over 19,000,000 class members (over half of the class members in my sample if one counts the *In re Capital One* as a single settlement) the class settlement was approved without any information given regarding the individual payout that class members could expect.

Another case in our sample, *Mack v. General Motors Financial*, was transferred out of the Northern District of Illinois and consolidated with a number of such TCPA class actions in the Middle District of California as *Newman v. Americredit Financial Services*.⁷³ Although *Mack* settled individually⁷⁴ the *Newman* class action settlement confirms suggests that the low 4 percent compensation rate in debt call class settlements in our sample is not an outlier.

The *Newman* settlement, like *Hanley* and *Gehrich*, involves a large nominal settlement fund, of \$6.5 million, with jointly stipulated attorney fees of \$2 million. Under the settlement, class members who do not submit proof of how many times their cellphones were called in violation of the TCPA are each entitled to \$30; with such proof, members get somewhere between \$60 and \$150, depending upon how many such calls they are able to document.

In arguing for approval of this settlement, class counsel in *Newman* argue that “assuming a claim rate of 4%, with 3.5% of claimants filing a claim without proof and .05% filing with proof at an average rate of \$90, Class Members would receive \$30 per cell phone number for no proof claims, and \$90 per cell phone numbers for claims filed with proof. This is consistent with recent California TCPA class action settlements.”⁷⁵ Class counsel’s memorandum in support of the proposed class settlement in *Newman* then goes on to provide information⁷⁶ on the actual per claimant payouts versus per class member payouts had all members claimed (thus indirectly indicating the per cent of class members claiming) in recent California TCPA cases:

Adams v. AllianceOne Receivables Management Inc.,⁷⁷: class members receiving a payout of \$40.00 (\$1.60 each if all members claimed), implying that 4% of class members were claiming;⁷⁸

⁷³ 11-cv-03041 (M.D. Cal. 2011).

⁷⁴ See *Newman v. Americredit Financial Services, Inc.*, Memorandum in Support of Plaintiff’s Second Amended Motion for Preliminary Approval of Class Action Settlement (Memorandum in Support), Docket Entry #63-1, p. 1, filed October 14, 2014.

⁷⁵ *Newman v. Americredit*, Memorandum in Support, supra note __ at 12.

⁷⁶ Memorandum in Support, supra note __ at 13.

⁷⁷ No. 08-cv-00248 (S.D. Cal. 2008).

⁷⁸ The Memorandum in support claims that this implies only 1% of class members were claiming, but this is incorrect, since if we have that the total fund F divided by N, all class members, equals \$1.60, but the actual payout when F is divided by pN, where P is the claims rate, equals \$40, then we solve for p = .04.

*Sarabi v. Weltman, Weinberg & Reis Co. LPA*⁷⁹, actual payout of \$48.21 per claimant versus \$.91 if all class members claimed, implying that 1.9% of class members claimed;

*Steinfeld v. Discover Financial Services et al.*⁸⁰, actual payout of \$20-\$40 versus \$.94 if every class member claimed, implying that the percentage of class members claiming was between 4.7% and 2.3%;

*Rose v. Bank of America Corp.*⁸¹, actual per claimant recovery of \$148.54 versus \$4.65 if the entire class claimed, implying a claims rate of 3.1%;

*Conmor v. JP Morgan Chase Bank, N.A.*⁸², actual per claimant recovery of \$69.97 versus \$4.07 if every class member claimed, implying a claims rate of 5.8%;

*Malta v. Freddie Mac & Wells Fargo Home Mgmt., Inc.*⁸³, actual payout of \$90 per claimant versus \$3 if every class member had claimed, for a claims rate of 3.3%.

This data from recent TCPA class actions brought in California federal court depicts payout ranges from 1.9% to 5.8%, with a median payout rate of 3.3%. Based on this sample of recent California TCPA class settlements, it would seem that the 6% claim rate in *Hanley* is actually quite high for a TCPA case against a financial institution, with *Gehrich*'s 2% figure being closer to the likely average claim rate.

In terms of how the cost of achieving a class settlement compares with the actual results for class members, TCPA class settlements seem to be almost as bad as FCRA and the old ATM EFTA notice failure class settlements. As shown by Figure 10 below, attorney fees as a fraction of the nominal class settlement may be high by the normal 33 percent contingency fee standard but they are at least less than the nominal settlement. However, for many case types, the attorney fees in TCPA settlements dwarf the actual amount received in aggregate by the class. For marketing fax settlements, which as noted above make up almost half of all TCPA class settlements, class counsel get fees that are on average equal to 352 percent of what the class members actually receive in compensation. Attorney fees in debt call class settlements, moreover, eat up 92 percent of what the class actually receives.

⁷⁹ No. 10-cv-01777, Docket # 42 (S.D. Cal. 2010).

⁸⁰ No. 12-cv-01118, Docket # 65 (N.D. Cal. 2014).

⁸¹ No. 11-cv-02390 (N.D. Cal. 2013).

⁸² No. 10-cv-01284 (S.D. Cal. 2010).

⁸³ No. 10-cv-1290 (S.D. Cal. 2010).

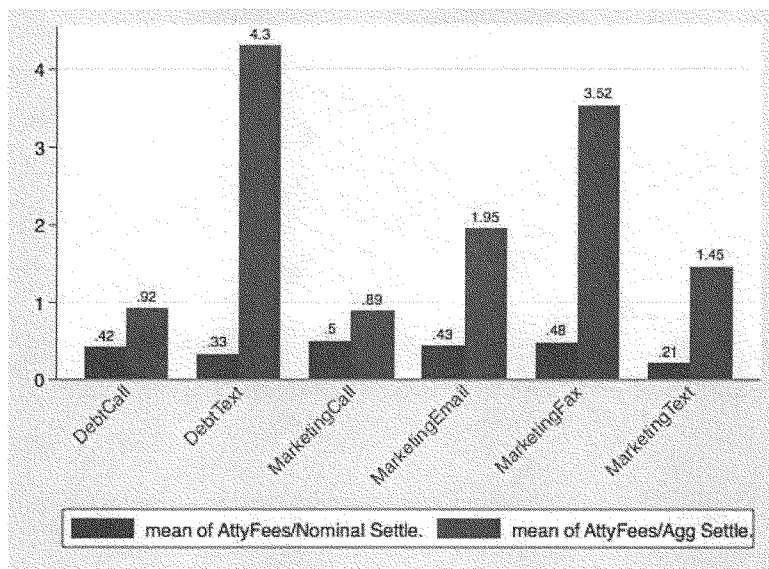


Figure 10. TPCA Attorneys Fees as Fraction of Nominal Settlement and Aggregate Payout

It is true that attorney fees in some of the largest TPCA class settlements are a much lower fraction of the aggregate class recovery. In the *In re Capital One* litigation (which included two class settlements in my sample), attorney fees are only 29 percent of the amount actually paid to the class. However, I have so far found little in the data explaining what it is that might cause federal trial judges to give attorneys more or less relative to the amount they have generated for the class. As reported in Table 5, in a simple linear regression with the ratio of attorneys fees to actual aggregate compensation as the dependent variable, there is no statistically significant relationship between the ratio of attorneys fees to actual aggregate compensation and any of the following variables: duration, class size, compensation rate, nominal settlement amount, aggregate payout, or whether the case was a debt call or not and whether the case was a marketing fax or not (although with $p < .32$, whether the case involved a marketing fax or not was the only relationship even approaching statistical significance).

AttyFees	Coef.	Std. Err.	T	P>t	[95% Conf.	Interval]
Duration	-37935.57	17025.92	-2.23	0.039	-73705.71	-2165.44
ClassSize	-.303436	.0724789	-4.19	0.001	-.4557085	-.1511635
Compensation Rate	132889.3	486525.4	0.27	0.788	-889262.6	1155041
AggSettle	.1184185	.1115681	1.06	0.303	-.1159774	.3528145
NominalSettle	.2449668	.1020743	2.40	0.027	.0305166	.4594169
Debtcalldummy	-364611.6	346686.6	-1.05	0.307	-1092973	363750
MarketFaxdummy	-1007518	327706.9	-3.07	0.007	-1696004	-319030.9
Constant	1701168	534183.5	3.18	0.005	578890.7	2823446

Table 5. Attorneys Fee Regression Results

As Table 5 shows, there is no statistically significant relationship between the actual results generated by class counsel -- what class members actually receive (the aggregate settlement variable) and the rate at which class members were compensated -- and the fees paid to class counsel (with $p < .30$ and $.79$ respectively). By contrast, the positive relationship between attorneys fees and the nominal settlement amount is highly significant ($p < .02$) and about what one would expect qualitatively, with attorneys getting 24 percent of increases in nominal settlement amount. Somewhat non-intuitively, attorneys fees fall, the longer the duration in months until settlement (by about \$38,000 per month), and the larger is the class size (by about 30 cents for each additional class member), with both effects highly significant. Finally, fees are statistically significantly lower in marketing fax cases but higher in non-debt call and non-marketing fax cases (marketing email, call or text and debt text).

III. Implications of the ND III Evidence for the Social Utility of Class Actions under Federal Consumer Protection Statutes

One must be cautious in drawing general implications from any particular sample, but as it stands, the evidence we have found in the Northern District of Illinois over the period 2010-2012 carries several implications for the performance of class actions under federal consumer protection statutes. It must be stressed that these implications only apply to cases brought under these statutes. As a subsequent paper will explain, consumer class action filings in the Northern District brought under state statute and common law have somewhat different implications for consumer class actions.

A. There are no "Small Dollar" Consumer Class Actions under Federal Consumer Protection Statutes

As discussed in the introduction, the basic economic rationale for consumer class actions is that when individual consumer harm is small, even though efficient deterrence requires forcing firms to pay for the harm they have caused, no consumer will find it in her self-interest to pursue a lawsuit. When claims are aggregated via the class action device, class counsel are given an incentive to bring suits that force firms to internalize the harm they have caused. Whether or not deterrence is optimal -- in the sense of imposing liability equal to the actual harm caused if and only if the firm has actually caused harm -- the class action at the very least forces firms to internalize some of the harm they cause at least some of the time.

All of the federal consumer protection statutes studied here award statutory damages of at least \$500 and more typically \$1000 or \$1500 without proof of harm. In every one of the 327 cases in our sample, the plaintiff asked for at least statutory damages. Thus there are no truly small dollar claims under the federal consumer protection statutes studied here. Whether or not \$500 is sufficient to incentivize an individual lawsuit may cannot be determined from our data. What can be determined is that federal consumer protection statutes have eliminated the very small \$20 or \$30 claim that is often taken to epitomize and justify consumer class actions.

B. Consumer class actions under federal consumer protection statutes are never tried, rarely generate binding legal precedent and may well be individually viable

The data also show that the value of consumer class actions in setting binding legal precedent that may guide future behavior may be more limited than some commentators assume. There are, to be sure, published opinions that emerge from the kind of class action litigations studied here. Courts have, for example, clarified in published opinions that the defendant in a TCPA case has the burden of showing that the consumer consented to be called. But while courts do issue opinions when they rule on motions to dismiss and summary judgment motions, very few such opinions are published.

While legal issues are resolved in opinions issued in the pretrial stage of cases in our sample, precisely zero cases in our sample of 327 consumer class actions ever went to trial before a bench or jury. The rare plaintiff judgments were all default judgments. Our data suggest that it is completely fanciful to argue that consumer class actions under federal consumer protection statutes involve a formal vindication of consumer rights.

What consumer class actions do most of the time is to generate an individual settlement. About half of the TCPA, FCRA and EFTA cases in our sample settled out individually. A full 70 percent of all FDCPA cases ended in an individual settlement. Somewhat ironically, consumer class actions under these statutes seem to do quite well at compensating the individual named plaintiff. As every indication from the data is that class counsel receive attorney fees in individual settlements, it seems fair to go a bit further and say that class actions compensate both the named plaintiff and her attorney. It may be well be that without the threat of proceeding to discovery in an attempt to certify the class, such individual settlements would not occur. However, the ubiquity of such settlements strongly suggests that the fees awarded just for obtaining individual settlements are sufficient to incentivize class counsel to bring lawsuit under federal consumer protection statutes that award statutory damages without proof of harm. This suggests that consumer class actions under these statutes may not be vital to either compensation or deterrence.

C. The Significance of No-Injury Class Actions under Federal Consumer Protection Statutes

As noted in the introduction, class actions with no allegation of actual harm to the plaintiff may be ruled to lack constitutional standing by the Supreme Court and have been banned by legislation recently passed by both houses of Congress. The data presented here show that such cases are an important fraction of all class actions filed under the

federal consumer protection statutes studied. The data also show that the probability of a class settlement may be statistically (significantly) higher in these cases than cases that do involve actual harm.

To measure the significance of no injury class actions in our data set, we need to identify such cases. We do so simply by examining whether the plaintiff alleged and/or attempted to prove that she suffered injury. Under this criterion, the following types of cases were no injury cases in this sample: EFTA ATM “on or at” notice failures; FCRA expiration date and employment background check formalities cases; lastly, FDCPA cases alleging a failure to follow formalities. This leaves TCPA filings. In passing the TCPA, Congress clearly found that unconsented autodialed communications cause at least some annoyance to the recipient, but also found that lack of consent was crucial to consumer harm. All TCPA filings in my sample allege that autodialed calls were made to the plaintiff without consent. For this reason, TCPA cases are not categorized as no injury cases. As is discussed in more detail below, however, courts have shifted to TCPA defendants the burden of proving that the plaintiff did consent. Thus TCPA plaintiffs merely must allege that they did not consent to the autodialed communication. Many TCPA cases may involve consent and no harm as Congress understood it. For this reason, I also consider the proportion of no injury filings and class settlements with TCPA filings removed from the sample.

Consider first the numbers on no injury filings with TCPA cases included. In the population of 327 total filings, we have a total of 148, or 45 percent with no allegation of injury to the plaintiff.⁸⁴ Thus even including all TCPA cases, no injury cases are almost half of the sample filings. As for the class settlement outcome, the question is whether no injury cases occur with a (statistically significant) higher probability among filings ending in class settlement than filings ending in other ways. No injury cases make up 47 percent of the cases ending in class settlement (40 out of 85), and 49 percent of cases that do not end in a class settlement (118 out of 242). This difference is not statistically significant, and in any event no injury cases are more likely in the set of filings that do not end in class settlement than in those that do.⁸⁵

These numbers are derived under the assumption that all TCPA cases are properly included as cases involving an allegation of harm. If we exclude TCPA filings from the sample, then we are left with 216 total filings, of which 158, or 73 percent, are cases with no allegation that the plaintiff suffered harm. In the sample with TCPA filings excluded, whereas 80 percent of the class settlements involved no injury filings, only 72 percent (or 118 out of 164) of filings that did not end in class settlement were no injury cases. Thus

⁸⁴ There are 43 ATM no harm filings, 44 FCRA expiration date or background check filings and 71 FDCPA formality filings, for a total of 148 no harm filings. Or $148/327 = 45$ percent no allegation of harm filings.

⁸⁵ In the full sample, with TCPA cases included as cases alleging harm, we have 327 total cases with 158 or a fraction of .48 involving no harm. Of the 242 cases not ending in class settlement, 118 (or .49 of the total) were cases were no injury cases as categorized in the text. Of the 85 cases ending in class settlement, 40 (or .47 of this sample) involved no harm. With a z statistic of only .33, the difference between the .49 rate at which no injury cases appear in the sample that does not end in a class settlement and the .47 rate at which they appear in the sample ending in class settlement is not statistically significant (we cannot reject the null of equal proportions).

with TCPA filings excluded, no injury cases are significantly more likely to end in class settlement than other types of filings.⁸⁶

D. Attorneys fees to class counsel that often exceed total class compensation suggest that consumer class actions are a highly inefficient method of compensation

In class settlements under the TCPA and FCRA – the largest class settlements – attorney fees for many case types are either as large as the amount paid out as compensation to the class or many times the size of that aggregate payout. Indeed, of all TCPA and FCRA class settlements, only for FCRA employment background check settlements do we find that attorney fees are less than half the aggregate payout to the class. For many commonly occurring class action settlements – such as in FCRA expiration date cases and TCPA cases involving marketing faxes – attorney fees are four and even nine times as big as the amount paid out to the class.

Of course the fees paid to class counsel are only one part of the total cost of achieving a class action settlement. It seems reasonable to expect that fees incurred by defense counsel are at least as large, and plus there is the opportunity cost of operating the cost system to pursue such class action settlements rather than adjudicating other kinds of cases. Based on our sample evidence, one would have to conclude that the total cost of achieving class action settlements is typically equal to many times the total amount recovered by the class. Were these class actions instead individual lawsuits, only a person motivated by spite and not by purely financial concerns would ever pursue a lawsuit that costs several times over what she could ever recover. As class action settlements establish no legal precedent, nor could the value in establishing a precedent for the future justify incurring such large fees.

The only exception to the pattern of attorney fees that may be several times as large as the class recovery is for settlements under the FDCPA. However, as a look back at Figure 6 confirms, attorney fees in FDCPA class settlements are always at least 2/3 of the class recovery, and for the most commonly occurring such settlement – involving a failure of FDCPA formalities – attorney fees are on average equal to the class recovery. Even in FDCPA cases, viewed purely as an instrument for mass compensation, class action settlements are enormously inefficient.

E. Data showing under most Federal Consumer Protection Statutes, only a small fraction of the class ever receive any compensation are further evidence of inefficiency

This inefficiency would be true even if class action settlements actually compensated most class members. But for only one type of class settlement – an FDCPA settlement involving a bad affidavit – was it true that the majority of class members were compensated. For all other case types, at most one-third or a half of the class were compensated. And for the most frequent class settlements – involving FDCPA formality failures, debt calls and marketing faxes in violation of the TCPA, and all FCRA settlements – fewer than a third and often only 10 to 15 percent of class members ever

⁸⁶ With the overall probability of a no injury case in the non-TCPA sample at .72, and such cases occurring in the class action settlement sub-sample of size 52 with probability .8 and in the no class settlement sub-sample of size 164 at probability .74, the z statistic equals 16, which is significant at the .0001 level.

receive a dollar under a class action settlement. Class action settlements do generate some compensation, but the vast majority of class members do not receive compensation.

F. Statutory damages without proof of harm incentivize the private pursuit of lawsuits where there is no harm to deter

Empirical evidence on whether a particular legal institution has effectively deterred some behavior is always difficult when one does not observe the underlying behavior that is to be deterred. However, even without a measure of underlying behavior, it remains true that the basic economic case for deterrence presumes that only harmful behavior should be deterred. Behavior that does not cause harm does not need to be deterred.

What is perhaps most striking about our Northern District sample is that high fraction of both case filings and class settlements in filings without even an allegation of harm to anyone. And if we exclude TCPA cases, then such no harm class actions are significantly more likely to be seen ending class settlement than in other types of case resolution. Under FCRA, it is now widely acknowledged that printing an expiration date on a credit card receipt cannot compromise cardholder identity. It also believed by many that failure of an employer to comply with the various disclosures and other formalities required by FCRA of employers who use employment background checks causes no harm to any employment applicant. The same is true for the most commonly occurring class settlement under the FDCPA, again one involving a failure to follow various disclosure formalities, a failure that does not cause harm to any employment applicant.

That so many class action settlements involved cases alleging such harmless violations provides a cautionary tale about the incentivizing effect of statutory damages in class actions. Relatively speaking, cases premised on a mere failure to follow statutory formalities are easy not only to plead but to evidence in the discovery phase. With statutory damages of up to \$1500 per plaintiff and no need to prove harm, once class counsel obtain sufficient evidence of the failure to comply with formalities, all that remains is to agree on a settlement amount. Arguably, all FCRA and most FDCPA settlements in my dataset represent precisely such a settlement, one in which the incredibly expensive class action is the vehicle by which the defendant pays for conduct that harmed no one.

G. Even Cases with Allegations of Harm may Actually Involve No harm to Anybody

It must be pointed out that other kinds of class settlements in my sample do involve behavior that Congress found to be harmful. The FDCPA is premised on the finding that when debt collectors attempt to collect on bad debts and threaten debtors with groundless litigation, they cause harm to debtors. The TCPA is premised on the Congressional finding that consumers are harmed when they are bothered by receiving an automatic phone call, voicemail, text, email or fax that they never consented to receive.

Observe, however, that the harm from such practices depends upon individually specific circumstances. Debt collectors are not prohibited from attempting to collect valid debts that are not time barred, and debt owners and collectors are legally permitted to and do bring lawsuits to collect on such debts. Consumers do consent to some autodialed calls, as when an insured gives her phone number to her insurance company so as to be alerted to changes in her health insurance plan. Thus the question for class

action settlements is whether settlements occur when they should – when the individual circumstances are such that the harm Congress cared about actually occurred and settlements may serve a valuable deterrent function – or instead are random, as likely to occur when there is no harm as when there is harm.

Cases in my sample provide reason for concern on this score. Consider the TCPA class settlements. Even allowing for the inclusion in my sample of one large multi-district consolidated class action, were one to extrapolate from the total payout in TCPA class settlements in my sample, it would not seem far-fetched to guess that across all federal district courts over the 2010-2012 period, TCPA class and attorney payouts were over \$500,000,000. This is not a trivial aggregate amount.

The non-trivial payouts in TCPA cases may well be justified on deterrence grounds because unlike the FCRA expiration date cases and FDCPA and FCRA cases alleging a failure to comply with formalities, a typical TCPA class action filing alleges the defendant engaged in conduct that Congress specifically found to be harmful to consumers. As the Ninth Circuit explained in *Satterfield v. Simon and Shuster*,⁸⁷ Congress passed the TCPA “in response to an increasing number of consumer complaints arising from the increased number of telemarketing calls. The consumers complained that such calls are a ‘nuisance and an invasion of privacy.’” The TCPA’s goal was to “protect the privacy interests of residential telephone subscribers by placing restrictions on unsolicited, automated telephone calls to the home and to facilitate inter-state commerce by restricting certain uses of facsimile machines and automatic dialers.”⁸⁸ With the obvious difficulty of precisely valuing the cost of such privacy invasions, the TCPA’s \$500 statutory damage provision – of \$500 willful violations – can be justified as way to deter privacy invasions without getting bogged down in a likely fruitless attempt to precisely value the harm they cause.

As the harm caused by an autodialed cellphone call or text – an invasion of privacy and annoyance – itself depends on the communication being unwanted by the consumer, the TCPA logically enough allows autodialed calls that are made with the “express consent” of the “called party,” and fax advertisements from senders with an “established business relationship” to recipients who have “voluntarily” communicated or made available to the sender their fax number.⁸⁹ Thus the TCPA explicitly recognizes that sometimes consumers may actually want to get autodialed calls notifying them of certain things or even fax advertisements. In these cases there is, almost tautologically, no harm to the consumer in receiving something that she has explicitly authorized (in the case of calls) or might well expect (in the case of faxes).

⁸⁷ 569 F.3d 946, 954 (9th Cir. 2009).

⁸⁸ *Satterfield v. Simon & Shuster*, supra note ____ at 954 (citing S. Rep. No. 102-178, at 1 (1991), reprinted in 1991 U.S.C.C.A.N. 1968.)

⁸⁹ More specifically, Section 227(b)(1)(A) and (B) allow autodialed phone calls made with “express consent” from the recipient and Section 227(b)(1)(C) permits unsolicited fax advertisements from “a sender with an established business relationship with the recipient...” where “(ii) the sender obtained the number of the telephone facsimile machine through— (I) the voluntary communication of such number, within the context of such established business relationship, from the recipient of the unsolicited advertisement, or (II) a directory, advertisement, or site on the Internet to which the recipient voluntarily agreed to make available its facsimile number for public distribution.”

Inasmuch as the harm from a TCPA violation depends upon whether a particular consumer consented to the class or had an ongoing business relationship with the defendant, one might argue that a class action is not an appropriate way to adjudicate claimed TCPA violations. Under Federal Rule of Civil Procedure 23(b), a court is to certify a class action seeking individual damages only if it finds that the court finds that “questions of law or fact common to class members predominate over any questions affecting only individual members.” The issue of whether the plaintiff in a TCPA action expressly consented to be called would seem to involve an individualized, fact-specific inquiry making class certification for such actions inappropriate under Rule 23. There are three cases in the N.D. Ill. sample where we have been able to verify that the defendant made this argument.⁹⁰ In one case, class counsel overcame this argument simply by defining the class to be all those consumers who received the allegedly unlawful communication without having consented. However, in a more thoughtful opinion, Judge Kendall found decisions from around the country on this issue had generated a rule that when a defendant set forth specific evidence “showing that a significant percentage of the putative class consented to receiving class on their cellphone,” the issues of individualized consent predominated, making class certification inappropriate.⁹¹ Based on the N.D. Ill. sample, it is clear that the vast majority of TCPA class actions may survive without serious inquiry into the predominance of class issues.

Another argument that defendants once made in TCPA cases is that a plaintiff alleging a violation of the TCPA must also allege and prove that she did not consent to receiving the cellphone call or fax (the latter by having an existing business relationship). Judicial interpretations of TCPA have said to the contrary that “prior express consent” under the TCPA is an affirmative defense on which the defendant bears the burden of proof; it is not a required element of the plaintiff’s claim.”⁹² The Federal Communications Commission (FCC), which administers the implementation of the TCPA, has agreed that the defendant has the burden of establishing that the plaintiff “expressly consented” to the communication.⁹³ Filings in my N.D. Ill. sample show that defendants do sometimes succeed in carrying this burden. Indeed, of the 6 TCPA cases that defendants won, only

⁹⁰ *Balbarin v. North Star Capital Acquisition LLC*, No. 10-cv-01846 (N.D. Ill.) (memorandum granting class certification, Docket No. 144); *Jamison v. First Credit Services*, 12-cv-04415 (N.D. Ill. 2012); *Hanley v. Fifth Third Bank*, Docket No. 18 (defendant’s answer and affirmative defenses), No. 12-cv-01612 (N.D. Ill. 2012).

⁹¹ *Jamison v. First Credit Services*, 12-cv-04415 (N.D. Ill. 2012) (finding class certification inappropriate where Honda showed that 1200 out of 2887 class members had provided their phone numbers and where individualized inquiry into Honda’s records would be required to determine whether the remaining class members had consented).

⁹² See *Thrasher-Lyon v. Ill. Farmers Ins. Co.*, 861 F. Supp. 2d 898, 905 (N.D. Ill. 2012); *D.G. v. Diversified Adjustment Serv., Inc.*, No. 11 C 2062, 2011 WL 5506078, at *3 (N.D. Ill. Oct. 18, 2011); *Martin v. Bureau of Collection Recovery*, No. 10 C 7725, 2011 WL 2311869, at *1 (N.D. Ill. June 13, 2011); see also *Grant v. Capital Mgmt. Servs., L.P.*, 449 F. App’x 598, 600 n.1 (9th Cir. 2011); *Pinkard v. Wal-Mart Stores, Inc.*, No. 3:12-cv-02902-CLS, 2012 WL 5511039, at *2 (N.D. Ala. Nov. 9, 2012).

⁹³ *In re Rules & Regs. Implementing Tel. Consumer Prot. Act of 1991*, 23 FCC Rcd. 559, 565 ¶ 10 (Jan. 4, 2008) (“Should a question arise as to whether express consent was provided, the burden will be on the creditor to show it obtained the necessary prior express consent.”).

two were won on substantive grounds but in both of these the defendant succeeded in establishing the affirmative defense of prior express consent by showing that the plaintiff had provided her phone number to a defendant with whom she had an ongoing business relationship knowing that it would be used by defendant or others⁹⁴ to contact her. These decisions were consistent with most earlier judicial decisions and FCC regulations as they existed at the time, as both had said that by showing that a consumer gave her number to a business with whom she had an existing business relationship, a TCPA defendant established express consent, with the burden then switching to the consumer to show that she had revoked that consent by requesting no further calls.⁹⁵

Following some district courts (including one decision in my N.D. Ill. sample),⁹⁶ the FCC has recently promulgated a rule under which TCPA defendants may no longer be able to establish express consent to an autodialed call or fax just by showing that the plaintiff provided her cellphone number to a provider with whom she has an established business relationship. Under a rule that took effect on October 16, 2013, TCPA defendants⁹⁷ must produce a “prior written consent,” where the “[t]he term *prior express written consent* means an agreement, in writing, bearing the signature of the person called that clearly authorizes the seller to deliver or cause to be delivered to the person called advertisements or telemarketing messages using an automatic telephone dialing system or an artificial or prerecorded voice, and the telephone number to which the signatory authorizes such advertisements or telemarketing messages to be delivered.”⁹⁸ Such written agreement must include a “clear and conspicuous disclosure” to the consumer she

⁹⁴ In *Elkins v. Medco Health Solutions, Inc.*, 12-cv-05617 (N.D. Ill. 2012), transferred and decided on summary judgment as 4:12-cv-02141 (E.D. Mo. 2014), the court found that the plaintiff expressly consented to receive telephone calls from her health plan’s pharmacy benefits manager advising her of cheaper prescription renewal options when she provided her phone number when she enrolled in a health plan agreement stating that the plan provider may use or share the information provided by the subscriber for “other businesses who work for the Plan...to tell you about treatment options or health related services.” In *Greene v. Direct TV*, 10-cv-00117 (N.D. Ill. 2010), the court found when she provided her cellphone number to Equifax knowing that potential creditors would use it as a contact number for potential fraud alert notifications, the plaintiff provided express consent for the defendant to use that number to contact her to verify her identity.

⁹⁵ According to a decades-old FCC rule, “[P]ersons who knowingly release their phone numbers have in effect given their invitation or permission to be called at the number which they have given, absent instructions to the contrary. Hence, telemarketers will not violate our rules by calling a number which was provided as one at which the called party wishes to be reached.” *In re Rules & Regs. Implementing Tel. Consumer Prot. Act of 1991*, 7 FCC Rcd. 8752, 8769 ¶ 31 (Oct. 16, 1992). See also *Elkins v. Medco Health Solutions*, supra note __, citing *In re Rules and Regulations Implementing the Telephone Consumer Protection Act of 1991*, 7 F.C.C.R. 8752, 8779 n. 47 (Oct. 16, 1992) (“subscribers may sever any business relationship, i.e., revoke consent to any future solicitations, by requesting that they not receive further calls from a telemarketer,...”).

⁹⁶ *Edeh v. Midland Credit Management Inc.*, 748 F.Supp. 1030, 1038 (D. Minn. 2010); *Thrasher-Lyon v. Illinois Farmers Commercial Ins. Co. and CCS Commercial*, No. 11-cv-04473 (N.D. Ill. 2011) (holding that while providing a phone number to a creditor may establish consent for auto-dialed calls from the creditor, this does not establish express consent to receive such calls from a debt collection company acting as an agent of the creditor).

⁹⁷ Other than calls and texts sent for debt collection purposes, provided that such calls or texts include or introduce any type of advertisement or marketing materials.

⁹⁸ 47 C.F.R. § 64.1200(f)(8).

is not required to sign the agreement as a condition to receiving any good or service but that by signing she consents to receiving telemarketing calls.⁹⁹

A final commonly occurring problem with the consent defense to a TCPA robocall violation arises when the defendant was provided the cellphone number by a customer but that customer no longer owns the number, which the phone company has in the meantime assigned to a different person. Cellphone number reassignments occur with perhaps surprising frequency, totaling about 37 million in 2011.¹⁰⁰ Several of the plaintiffs in our TCPA cases were called on cellphone numbers that had been given to defendants not by the plaintiffs but by previous holders of that number.¹⁰¹ In such cases, defendants argued that they have “consent” under the TCPA to make such calls. Plaintiffs argued that when in the TCPA Congress allowed robocalls made with the prior express consent of the “called party,”¹⁰² it meant the party actually called and did not mean to create an implicit exception for calls inadvertently made to people who had never actually consented. Thus far, the federal courts of appeals have sided with the plaintiffs, uniformly holding that when Congress said that the “called party” needs to have consented, it meant the current phone subscriber.¹⁰³

Such decisions may seem relatively straightforward as a matter of statutory interpretation, but they raise deeper issues regarding the normative desirability of TCPA liability. Prominent commentators¹⁰⁴ have argued that by threatening companies with the kind of multi-million dollar class action settlements found in my N.D. Ill., dataset, TCPA liability for robo-calls inadvertently made to the wrong person will chill valuable communications, such as calls sending fraud and identify theft alerts and reminders of appointment and due dates. Other commentators have found it “amazing” that TCPA liability in this situation is even a “topic of debate,” reflecting the current “zeitgeist” in which the potential for liability to increase firm costs and prices itself counts as an argument against liability.¹⁰⁵ Still, the inadvertent wrong number TCPA debt collection calls are yet another indication of the questionable utility on deterrence grounds of many TCPA class settlements.

IV. Improving Consumer Class Actions under Federal Consumer Protection Statutes

⁹⁹ 47 C.F.R. § 64.1200(f)(8)(i)(A) and (B).

¹⁰⁰ Alyssa Abkowitz, Wrong Number? Blame Company's Recycling, Wall Street Journal, Dec. 1, 2011, available at <http://www.wsj.com/articles/SB10001424052970204012004577070122687462582>.

¹⁰¹ Most notably, Soppet v. Enhanced Recovery Corp. & Illinois Bell Telephone Co., 10-cv-05469 (N.D. Ill. 2010).

¹⁰² In 47 U.S.C. § 227(b)(1)(A)(iii)(2006).

¹⁰³ See Osorio v. State Farm Bank, 746 F.3d 1242 (11th Cir. 2014), Soppet v. Enhanced Recovery Co, LLC, 679 F.3d 637 (7th Cir. 2012).

¹⁰⁴ Perhaps most prominently Adonis Hoffman, Sorry, Wrong Number, Now Pay Up, Wall Street Journal, June 15, 2015, available at <http://www.wsj.com/articles/sorry-wrong-number-now-pay-up-1434409610?KEYWORDS=sorry+wrong+number>.

¹⁰⁵ Lincoln Caplan, Paying for Robo-Calls, New York Times, May 18, 2012, available at ...

A. Better Judicial Monitoring

How, one might ask, could the current class action system have evolved to become one in which the amount paid in attorney fees is often equal to or greater than the amount of compensation actually received by class members and in which very few class members receive anything? By hypothesis and by fact, class actions involving numerous plaintiffs with small injuries do not have an actual plaintiff group who will monitor class counsel. Judges are supposed to monitor class actions, ensuring that a class action is legally justified, and also in ensuring also that any settlement in a class action actually promotes the interests of the absent class members. The idealized judicial role is described by Hensler:¹⁰⁶

“Judges play a unique role in damage class actions: Without the judge’s decision to grant certification, a class action lawsuit does not exist. Without the judge’s approval, a lawsuit cannot be settled. Without a judge’s decision to award fees, the class action attorneys cannot be paid.Even after a case is resolved, judges may continue to play a role by overseeing the disbursement of settlement funds.”

However, a very basic economic model of judicial preferences suggests that judges may have little incentive to conform to this ideal. Judges may be assumed to value not only leisure but also prestige – their standing with other judges and the public at large.¹⁰⁷ Assuming that prestige declines both when a trial judge is reversed on appeal and when court queues grow too long (partly because of the direct implication that the judge is lazy in failing to resolve cases, and partly because long queues lead to public pressure to increase the number of judges, which lowers the prestige of being a judge), trial judges will be attracted to case resolution methods that keep queues from getting too long but also minimize the chance of a potentially embarrassing reversal. Approving class action settlements is an ideal method of case resolution from this judicial point of view: dockets are cleared with a very low probability of reversal.

As part of approving such class action settlements, judges also approve fees to the plaintiffs’ attorneys. While trial judges may be reversed on appeal for failing to certify a class, they are rarely if ever reversed for approving a settlement and its attendant attorney’s fee award.¹⁰⁸ Thus what Helland and Klick call “judicial expediency” explains why judges routinely approve class action settlement with relatively large attorney fees but little actual compensation to class member.

The rough data are consistent with this judicial expediency story, as Eisenberg and Miller’s update to include cases from 2003 to 2008 found that judges granted the requested attorney fee in 70 per cent of the cases.¹⁰⁹ More careful statistical analysis also has tended to confirm the judicial expediency hypothesis. Working with the Eisenberg and Miller dataset, Helland and Klick add to the list of explanatory variables a measure of court congestion (annual case terminations by judge), and find a significant relationship

¹⁰⁶ Deborah Hensler, Nicholas Pace, Bonita Dombrey-Moore, Beth Giddens, Jennifer Gross, and Erik Moller, *Class Action Dilemmas: Pursuing Public Goals for Private Gains* 445 (Rand, 2000).

¹⁰⁷ Eric Helland and Jonathan Klick, *The Effect of Judicial Expedience on Attorney Fees in Class Actions*, 36 J. Legal Stud. 171, 173 (2007).

¹⁰⁸ See Helland and Klick, *supra* at 175-176, discussing the evidence.

¹⁰⁹ Theodore Eisenberg and Geoffrey P. Miller, *Attorney Fees and Expenses in Class Action Settlements: 1993-2008*, 7 J. Empirical Legal Stud. 248, 250 (2010).

between court congestion and attorney fees, with the fee increasing by .15 per cent for every 1 per cent increase in terminations.¹¹⁰

Whatever may be the explanation, it seems clear that judges are not monitoring class action settlements in a way that ensures that compensation is actually paid to class members and that attorney fees bear a reasonable relationship to the amount actually received by class members. A simple way to improve the performance of consumer class action settlements would be for federal trial judges to 1) wait to approve attorney fee awards until class counsel submit an accounting showing the actual compensation rate and the aggregate amount paid to the class, and then 2) base attorney fees on both the aggregate payout and the compensation rate. Rather than basing attorney fees on the customary range of attorney fees to nominal settlement for a particular case type (say TCPA debt call), district judges would award attorney fees that increase with the compensation rate and the aggregate compensation. Attorneys would receive, for example, 33 per cent of the nominal settlement only if aggregate compensation paid equaled the full amount called for under the terms of the nominal settlement. For typical class settlements, attorney fees would be lower, the lower is the aggregate compensation actually paid to the class. The goal would be to ensure not only that the cost of generating the common fund recovery is less than the fund, but also to ensure that the bigger the fraction actually paid to class members, the bigger is class counsel's compensation.

The justification for such a relationship between attorney fees and the actual aggregate class recovery lies in the basic economic idea that if a class action were instead an individual suit, then no rational plaintiff would agree to pay fees exceeding her own recovery, but such a plaintiff would agree to pay counsel more, the greater is her own recovery. Such an arrangement in fact describes the way contingency fees in individual personal injury actions work. The class action is essentially a substitute, employed in cases where individual damages are too small for the typical contingency fee to create adequate incentives for lawsuits. But the individual contingency fee would provide the model for class action fees.

It may be objected that the class action is more than a substitute for an individual action, that class actions generate external benefits that individual actions do not and that relative to all benefits, attorney fees are not disproportionate. The data analyzed here do not generally support this argument. In terms of contributing to the stock of legal capital, consumer class actions under federal consumer protection statutes generate few legal precedents that guide future behavior and are never tried on the merits. As far as future deterrent value goes, statutory damages without proof of injury clearly incentivize class counsel to bring cases where there is likely no harm to deter in the future. Cases that do involve actual individual harm, such as attempts by debt collectors to collect on bad debts that are not legally collectible, usually end in individual settlements that provide no external benefits.

¹¹⁰ Helland and Klick, *Effect of Judicial Expediency on Attorney Fees*, at 181.

Appendix 1.
Class Settlements in EFTA ATM Notice Failure Cases

Case Name (date filed/settled)	Nominal Class Settlement	Attorney Fees	Claims Submitted, Actual Class Payout and as Fraction of Class Settlement Fund	Payout per Class Member	Attorney Fees as Fraction of Settlement	Attorney Fees as Fraction of Actual Class Payout
<i>Goldshteyn v. Argonne Credit Union</i> , 10-cv-05402, 8/10-4/12	\$150,000	\$50,000	Only net of \$100,000 available for class, 42 class members certified receiving payout of \$1000 each = \$42,000 = 28% Settlement Fund (SF). "Hundreds" of class members, 46,292 ATM transactions during relevant period	\$1000	33%	119%
<i>Barreto v. Center Bank</i> , 10-cv-06554, 10/10-8/11	\$40,000 (balance cy pres to Chicago Bar Fdn).	\$12,000	18 valid claims = 5% of total class, \$1000 each, \$18,000 total = 45% of SF	\$1000 plus \$2000 to named plaintiff; \$7181 in notice and admn costs	30%	66%
<i>Louisma v. Automated Financial LLC</i> , 11-cv-02104, 3/11-9/12	\$53,000 (not incl. class counsel attys' fees) so including fees, total of \$110,000	\$57,000	44 claims forms submitted (23 late)@\$900 = \$39,600 = 79% of SF. Balance cy pres to Chicago Bar Fdn. More than 20,000 ATM transactions during period	\$900 plus \$1500 each to two named plaintiffs; \$2548 settle. Admn. costs	57%	144%
<i>Nguyen v. South Central Bank</i> , 11-cv-02612, 4/11-9/12	\$150,000	\$50,000	12,000 transactions at un-noticed ATM, but only 75 valid claims submitted aggregated payout of \$75,000 = 50% nominal fund.	\$1000 plus \$1500 per x 2 named plaintiffs + \$2657 notice costs	33%	66%

<i>Cole v. Automated Financial LLC</i> , 11-cv-03299, 5/11-9/12	Consolidated with <i>Louisma</i> , supra, same settlement					
<i>Jones v. South Central Bank</i> , 11-cv-04389, 6/11-9/12	Consolidated with <i>Nguyen</i> , supra, same settlement					
<i>Loewy v. RBS Citizens Bank</i> , 11-cv-04872, 7/11-3/12	\$100,000	\$30,000	26 valid claims/210 class members = 12%; @\$150 x 26 = \$3900 = 4% SF. SF Balance, 27% to Legal Clin. NWU Law Sch. 13% to Chicago Legal Clin.	\$150 + \$1000 to named plaintiff	30%	770%

**The Consumer Financial Protection
Bureau's Arbitration Study
A Summary and Critique**

Jason Scott Johnston
and Todd Zywicki

August 2015

MERCATUS WORKING PAPER

Jason Scott Johnston and Todd Zywicki. "The Consumer Financial Protection Bureau's Arbitration Study: A Summary and Critique." *Mercatus Working Paper*, Mercatus Center at George Mason University, Arlington, VA, August 2015.

Abstract

The Consumer Financial Protection Bureau's *Arbitration Study: Report to Congress 2015* does not support the case for ex ante regulation of mandatory consumer arbitration clauses. It contains no data on the typical arbitration outcome—a settlement—and it is these arbitral settlements, and not arbitral awards, that should be compared to class action settlements. It does not address the public policy question of whether, by resolving disputes more accurately on the merits, arbitration may prevent class action settlements induced solely by defendants' incentive to avoid massive discovery costs. It shows that in arbitration consumers often get settlements or awards, are typically represented by counsel, and achieve good results even when they are unrepresented. In class action settlements, the Consumer Financial Protection Bureau reports surprisingly high payout rates to class members and low attorneys' fees relative to total class payout. These aggregated average numbers reflect the results in a very small number of massive class action settlements. Many class action settlements have much lower payout rates and higher attorneys' fees.

JEL codes: K2, G2, K23, K41

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The Consumer Financial Protection Bureau's Arbitration Study

A Summary and Critique

Jason Scott Johnston and Todd Zywicki

I. Introduction

For decades, legal commentators have debated the normative desirability of clauses in consumer contracts that require consumers to arbitrate rather than litigate claims against providers of consumer products and services.¹ Consumer advocates have been especially concerned that, by precluding consumer class actions, such mandatory arbitration clauses will leave consumers without any effective remedy for violations of consumer contracts and allow even more egregious corporate misconduct that violates state and federal consumer protection statutes.² However, although many consumer contracts clearly include clauses requiring consumers to arbitrate claims, there is relatively little systematic empirical evidence about how consumers fare in either arbitration or consumer class actions. With dozens of state and federal consumer protection statutes aimed at both compensating consumers and deterring corporate misconduct, empirical evidence on the effectiveness of arbitration versus consumer class action has been needed badly.

In enacting the Dodd-Frank Wall Street Reform and Consumer Protection Act,³ Congress finally joined the debate over arbitration versus class action relief in consumer financial contracts. Under Dodd-Frank, pre-dispute mandatory arbitration clauses are unconditionally banned in contracts for residential mortgages and home equity loans.⁴ For most other types of consumer financial contracts, however, Dodd-Frank delegates to federal agencies

¹ See sources cited in Jean R. Sternlight, *Mandatory Binding Arbitration Clauses Prevent Consumers from Presenting Procedurally Difficult Claims*, 42 SW. U. L. REV. 87, 87 n.1 (2012).

² For examples of this view, see David S. Schwartz, *Claim-Suppressive Arbitration: The New Rules*, 87 IND. L.J. 239 (2012); Maureen Weston, *The Death of the Class Action After Concepcion?*, 60 U. Kan. L. REV. 767 (2012).

³ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

⁴ *Id.* § 1414.

the job of gathering more systematic evidence about arbitration. Section 1028(a) of Dodd-Frank requires the newly created Consumer Financial Protection Bureau (CFPB) to provide Congress with a report on “the use of agreements providing for arbitration of any future dispute between covered persons and consumers.”⁵ As for what the CFPB is to do after it issues such a report, section 1028(b) grants the CFPB the authority to “prohibit or impose conditions or limitations on the use of an agreement between a covered person and a consumer for a consumer financial product or service providing for arbitration of any future dispute between the parties, if the Bureau finds that such a prohibition or imposition of conditions or limitations is in the public interest and for the protection of consumers.” For arbitration clauses in broker–customer contracts, Dodd-Frank commands that the Securities and Exchange Commission (SEC) conduct a similar study.⁶

Although nothing indicates that the SEC will be reporting anytime soon on arbitration clauses in broker–customer contracts,⁷ the CFPB has now issued two reports on arbitration in consumer financial contracts: the December 2013 *Preliminary Results* study (hereafter preliminary results)⁸ and the March 2015 *Arbitration Study: Report to Congress 2015* (hereafter Report).⁹ The CFPB substantially added to the Report while incorporating the earlier preliminary results. Although the tone and conclusions of the Report are measured and cautious, many commentators have interpreted it as a prelude to aggressive regulation of arbitration agreements

⁵ *Id.* § 1028(a).

⁶ Section 921 of Dodd-Frank also requires the Securities and Exchange Commission to study and report on the use of mandatory arbitration clauses in broker–customer contracts.

⁷ As noted by George H. Friedman, *What’s a Regulator to Do? Mandatory Consumer Arbitration, Dodd-Frank, and the Consumer Financial Protection Bureau*, 20 DISP. RESOL. MAG. (2014) (citation omitted) available at http://www.americanbar.org/publications/dispute_resolution_magazine/2014/summer/what-s-a-regulator-to-do--mandatory-consumer-arbitration--dodd-f.html (“Given the more than 90 mandatory study and rulemaking requirements the SEC has under Dodd-Frank, it is not at all surprising that arbitration is not high on the agency’s priority list.”)

⁸ CONSUMER FIN. PROT. BUREAU (CFPB), ARBITRATION STUDY: PRELIMINARY REPORT (2013).

⁹ CFPB, ARBITRATION STUDY: REPORT TO CONGRESS 2015 (2015).

in consumer credit contracts¹⁰ or perhaps even as an outright ban on mandatory arbitration clauses. Deepak Gupta, who acted as senior counsel for enforcement strategy at the CFPB during the new federal agency's founding in 2011–2012, has told the press that prohibiting or restricting mandatory arbitration would be “the single most transformative thing the bureau can do” for consumers.¹¹ In May 2015, 58 members of Congress wrote to CFPB Director Richard Cordray, pointing to the findings of the study and “urg[ing] the CFPB swiftly to undertake a rulemaking to eliminate the use of forced arbitration clauses in these contracts.”¹²

Proponents of that view particularly point to the Report's apparent enthusiasm for the use of class action litigation to resolve disputes involving consumer credit products instead of arbitration. Although the Report draws no firm conclusions, it may seem to suggest that arbitration is often an ineffective means for compensating consumers in disputes involving consumer credit products and that class action cases are an attractive alternative. If that is the implied message, then the CFPB may attempt to point to its Report as providing a foundation for banning or restricting the use of mandatory arbitration clauses in consumer credit contracts such as contracts for credit cards, prepaid cards, checking accounts, and payday loans, just as Dodd-Frank itself prohibits arbitration in mortgage and other contracts.

The CFPB's Report, however, provides no foundation for imposing new restrictions or prohibitions on mandatory arbitration clauses in consumer contracts. Although the Report provides some useful new information about the use of arbitration clauses in contracts involving

¹⁰ As we note later, the Report is not limited to products that constitute “consumer credit,” such as credit cards; it also includes a variety of consumer financial products, such as checking accounts, prepaid cards, and even cell phone contracts. Nevertheless, in this paper, we will frequently use the term *consumer credit contracts* as a shorthand for this range of contracts involving consumer financial products.

¹¹ Carter Dougherty, *CFPB Finds Arbitration Harms Consumers, Presaging New Rules*, BLOOMBERG BUS., March 20, 2015, available at <http://www.bloomberg.com/news/articles/2015-03-10/cfpb-finds-arbitration-harms-consumers-in-study-presaging-rules>.

¹² Letter from Sen. Al Franken et al. to Richard Cordray, Director, Consumer Financial Protection Bureau (May 21, 2015), available at <http://www.cfpbmonitor.com/files/2015/05/150521CFPBArbitrationLetter.pdf>.

consumer financial services, its findings fail to support any conclusion that arbitration clauses in consumer credit contracts reduce consumer welfare or that encouraging more class action litigation would be beneficial to consumers and the economy. Most importantly for public policy purposes, the CFPB's data do not allow for meaningful comparison between arbitration and class actions. The CFPB's Report sheds no light on what is perhaps the key public policy question: whether class action settlements often represent a deal struck by defendants to avoid massive discovery costs threatened in lawsuits of questionable substantive merit, whereas arbitration may resolve individual claims more accurately in terms of the substantive merits of the dispute.

Instead, the CFPB's Report presents mountains of data on outcomes in arbitration and in class action lawsuits. These data suffer from a number of shortcomings. The CFPB is to be lauded for looking at thousands of actual case files and docket sheets for details on class action settlements. But by presenting data on what consumers recover when arbitrators make a judgment in their favor but no data on what consumers recover when arbitrations settle—the likely outcome in a majority of arbitrations that the CFPB studies—the CFPB invites a false apples-to-oranges comparison between class action *settlements* and arbitral *awards*. The CFPB did not have access to data on the amount of arbitral settlements, but it should have clearly cautioned against drawing a comparison between arbitral awards and class action settlements.

As for the CFPB's data on class action settlements, its sample of class action settlements likely includes many settlements in lawsuits against debt collection agencies. Because debt collectors are not parties to an arbitration clause between the consumer and the creditor, a debt collector cannot avail itself of an arbitration clause in the contract between the consumer and creditor. The CFPB said that it only included class settlements involving disputes to which an arbitration clause might have applied. As the debt collector settlements were not such disputes, if

the CFPB had consistently applied its own rule for determining which class settlements to include in the sample it studied, then the CFPB would have excluded the large number of debt collector class action settlements.

More seriously, the CFPB's data on two measures—on the fraction of consumers actually receiving a payment under a class action settlement (the claims rate) and on attorneys' fees as a fraction of the total amount paid to class members—are aggregate averages. To construct these aggregate averages, the CFPB counts the number of class members paid, and the total amount paid in attorneys' fees, and divides those numbers by, respectively, the total number of class members and the class payment. The problem with that approach is that it tends to overweight data from only half a dozen huge class action settlements. The outcomes in this very small number of class action settlements dominate the CFPB's reported data. Were the CFPB to have broken down claims rates and attorneys' fees by case type—for example, settlements under the Telephone Consumer Protection Act (TCPA)—then its data would likely have revealed not only that substantial variation exists across case types in both the claims rate and the size of attorneys' fees, but also that for some case types, such as TCPA settlements, only about 5% of consumers ever receive a payout in typical class action settlements, whereas attorneys' fees are on average almost as large as the total amount paid to the class.

As for the CFPB's arbitration data, the CFPB discovered that for most financial products, some providers require arbitration of disputes, but others do not. When arbitration is required, the CFPB found that a majority of consumers are represented by counsel in arbitration, with an even higher fraction represented when there is an issue regarding a disputed debt. At the same time, the CFPB found that arbitration is such a simple and cheap process (now requiring only a \$200 filing fee) that consumers achieve good outcomes even when they are not represented by counsel.

Finally, we find the CFPB's data from consumer surveys very significant. When consumers were asked what they would do if a credit card company failed to remove a fee that the consumer complained had been wrongly assessed, very few said that they would resort to calling a lawyer. Instead, the vast majority of consumers said that they would simply cancel their accounts and take their business elsewhere. Our data indicate that this consumer market response is credible and real: as economic theory predicts, financial institutions seem to respond to the threat of losing a consumer's business by waiving various fees and charges on a case-by-case basis. For the vast majority of consumer disputes involving small claims, the market creates incentives for firms to resolve such disputes internally.

Our conclusion, therefore, is that although the CFPB Report has some new information about both arbitration and class action litigation as alternative devices for resolving consumer financial disputes, the Report does not provide much of the key information necessary to fully evaluate the relative roles of arbitration and class actions as ex post dispute resolution mechanisms for consumer cases. Substantially more and different evidence would be necessary to conclude that consumers are harmed by arbitration or that they would benefit from unleashing class action litigation more routinely. The propriety of caution in moving to restrict arbitration agreements on the basis of the CFPB's findings is especially appropriate in light of the well-established public policy favoring the use of alternative dispute resolution techniques. As the Supreme Court has repeatedly emphasized in opinions upholding mandatory arbitration clauses, when in the Federal Arbitration Act, the U.S. Congress made pre-dispute mandatory arbitration clauses "valid, irrevocable and enforceable,"¹³ it expressed both a "liberal federal policy favoring

¹³ The statute, Federal Arbitration Act, 9 U.S.C. § 2 (1925), continues to say "... save upon such grounds as exist in law or equity for the revocation of any contract."

arbitration” and the “fundamental principle that arbitration is a matter of contract.”¹⁴ Before regulation overrides such a well-established policy, substantial and rigorous evidence must show that arbitration is significantly worse for consumers than are the existing institutional alternatives.

In this paper, we will analyze the Report’s methodology and conclusions and identify the Report’s limitations as a basis for aggressive regulation of arbitration provisions in consumer credit contracts.

II. Well-Established Public Policy That Favors Arbitration over Litigation

In recent years, the Supreme Court has made it crystal clear that the policy favoring arbitration expressed in the Federal Arbitration Act preempts efforts by state courts, in particular, to declare that arbitration clauses are unenforceable on public policy grounds. More precisely, in *AT&T Mobility v. Concepcion*, the Supreme Court squarely addressed holdings by a number of state courts that arbitration clauses waiving class action litigation were unenforceable on grounds of unconscionability or public policy. Those courts¹⁵ had reasoned that class action relief was necessary to secure an important goal underlying state consumer protection statutes—that of deterring firms from misbehavior that inflicts harm on consumers that is so small that individual claims are not viable but that is large in the aggregate. Relying solely on affidavit evidence from trial attorneys, these courts had held that individual arbitration could not effectuate this goal

¹⁴ *AT&T Mobility v. Concepcion*, 563 U.S. 321, 131 S. Ct. 1740, 1745 (2011), quoting *Rent-A-Center, West, Inc. v. Jackson*, 561 U.S. 63, 67 (2010).

¹⁵ Perhaps the most prominent example is the California Supreme Court in *Discover Bank v. Superior Court*, 36 Cal. 4th 148, 113 P.3d 1100 (2005), the case relied on by the California Supreme Court in declaring unenforceable the arbitration clause at issue in *Concepcion*. Under the narrow reading of the *Discover Bank* holding put forward by *Concepcion*, the court’s rule striking down class action waivers was limited to such waivers in adhesion contracts in which the consumer alleged that small damages were incurred because of the defendant’s scheme to “cheat” consumers. But other state supreme courts had relied on essentially identical reasoning without similar doctrinal limits. See, e.g., *Scott v. Cingular Wireless*, 161 P.3d 1000 (Wash. 2007).

because attorneys would not undertake such representation on an individual basis, even in arbitration. With class action relief waived, these courts had found that small consumer claims would not be effectively pursued, thus leaving consumers uncompensated and firms undeterred from misbehavior that generated such small, nonviable consumer claims.¹⁶

Concepcion was precisely the kind of small stakes consumer contract dispute for which state courts had claimed that individual arbitration could not substitute for class action–style relief. The plaintiffs in *Concepcion* alleged that AT&T had engaged in false advertising and fraud by charging them a \$30.22 sales tax on a phone that it had advertised as being free. Under AT&T’s arbitration clause, for claims less than \$10,000, a consumer wishing to pursue a claim in arbitration could do so over the phone, via written submissions, or in person. If the consumer received an arbitration award larger than AT&T’s last settlement offer, then under the clause, AT&T promised to pay a minimum of \$7,500 plus the claimant’s attorney fees.¹⁷ The District Court in *Concepcion* thought highly of this arbitration mechanism, finding that it was “quick, easy to use” and likely to “promptly full or . . . even excess payment to the customer without the need to arbitrate or litigate” and that the \$7,500 premium functioned as “a substantial inducement for the consumer to pursue the claim in arbitration.”¹⁸ Still, it found that under California law, AT&T’s clause was unenforceable because AT&T had failed to show that arbitration under its clause could adequately substitute for the deterrent effect of class action relief.

¹⁶ Some courts, such as the California Supreme Court in *Discover Bank*, tried to be careful to say that they were ruling arbitration clauses unconscionable so that their decisions would be protected from preemption by language in section 2 of the Federal Arbitration Act, which says that arbitration clauses are enforceable “save upon such grounds as exist at law or in equity for the revocation of any contract.” 9 U.S.C. § 2 (2006). Other courts, such as the Washington Supreme Court in *Scott v. Cingular Wireless*, were willing to simply say that mandatory arbitration clauses in consumer contracts were void as against state public policy. As discussed later in this paper, the Supreme Court did not find at all persuasive the idea that *Discover Bank* represented just a routine (or case-specific) finding of unconscionability.

¹⁷ This summary of the clause is taken from the Court’s opinion in *Concepcion*.

¹⁸ *AT&T Mobility v. Concepcion*, 131 S. Ct. 1740, 1745 (citing *Laster v. T-Mobile USA, Inc.*, 2008 WL 5216255, *11–*12) (S.D. Cal., Aug. 11, 2008).

In reversing the Ninth Circuit affirmance in *Concepcion*, the Supreme Court ruled that by effectively requiring that consumers be given the choice between individual versus classwide relief ex post, the California Supreme Court’s approach to mandatory arbitration in consumer contracts would create an inevitable incentive for such classwide dispute resolution. This incentive, the Court held, struck at the heart of the federal policy favoring arbitration, for “the switch from bilateral to class arbitration sacrifices the principal advantage of arbitration—its informality—and makes the process slower, more costly, and more likely to generate procedural morass than final judgment.”¹⁹

Since *Concepcion*, the Supreme Court has continued to reject challenges to the enforceability of arbitration clauses that are based on the supposed loss of deterrence entailed by mandatory arbitration. In 2013, in *American Express v. Italian Colors Restaurant*²⁰ (*Amex II*), the Court ruled enforceable a clause mandating arbitration and waiving classwide relief even for claims alleging violations of federal antitrust law. The plaintiff in *Amex II* had argued that no plaintiff’s attorney would incur the enormous cost of hiring the experts necessary to have a chance of winning such a case unless individual claims were aggregated to allow classwide damages. The Supreme Court saw no merit in this argument, responding to it by commenting simply that in *Concepcion*, “we specifically rejected the argument that class arbitration was necessary to prosecute claims ‘that might otherwise slip through the legal system.’”²¹

The Supreme Court’s conclusion in *Amex II* is particularly informative about the Court’s attitude toward arbitration and its potential. The affidavit evidence in that case—that the expert witnesses that are necessary to pursue such cases are a large expense that can be justified only by

¹⁹ *Id.* at 1751.

²⁰ 470 U.S. 213, 133 S. Ct. 2304 (2013).

²¹ *Id.* at 2312 (citing *Concepcion*, 131 S. Ct. at 1753).

the prospect of aggregate recovery—likely struck many antitrust litigators as accurate. However, the conclusion that such aggregate recovery can be achieved only through class actions is not one the Court was ready to accept. Class action law firms already have begun to file mass arbitrations for antitrust violations, and an online consumer organization even helps consumers join such mass arbitrations.²² The Court's broad interpretation of the Federal Arbitration Act reflects its view that Congress wants arbitration to be given every chance to succeed. The Supreme Court's now quite extensive jurisprudence on arbitration has made clear that the strong presumption in federal law in support of arbitration rests in large part on the idea that consumers benefit from the speed, simplicity, and low costs of arbitration. An often-repeated argument is that much of this benefit comes in the form of lower consumer prices.²³ As we explain later in this paper, the decreased consumer prices may result from the lower litigation costs, but the magnitude of the decrease may be difficult to estimate. However, as we also stress, arbitration may benefit consumers further by improving firm incentives to invest in accurate internal dispute resolution systems that preclude external dispute resolution in whatever form. And, of course, consumers may benefit from being able to participate directly in a cheap, quick, and informal method of dispute resolution.

Whatever the range of benefits to consumers from arbitration may be, the Supreme Court is clearly of the view that Congress may well have understood there to be many benefits. At the same time, the chorus of criticism regarding class action litigation has grown in recent years. As a result of those criticisms, initiatives at both the state and the federal levels have attempted to

²² See Sternlight, *supra* note 1, at 92.

²³ See Stephen J. Ware, *Paying the Price of Process: Judicial Regulation of Consumer Arbitration Agreements*, 1 J. DISP. RESOL. 89, 90–93 (2001); Stephen J. Ware, *The Case for Enforcing Arbitration Agreements—With Particular Consideration of Class Actions and Arbitration Fees*, 5 J. AM. ARB. 251 (2006); Peter B. Rutledge, *Whither Arbitration?*, 6 GEO. J.L. & PUB. POL'Y 549, 575–76 (2008).

pare back class actions and to ensure that class actions truly further the cause of justice and result in compensation to consumers for real harms suffered, rather than simply providing an outsized payment to class action lawyers to resolve nuisance litigation.

Those efforts have been met by a campaign by class action attorneys, law professors, and consumer advocates to delegitimize arbitration while supporting class actions for disputes involving consumer products and services.²⁴ Given the hostility of those interests to arbitration, it was not unexpected that they would celebrate the tone of the CFPB's Report as signaling a move toward restrictions on arbitration agreements. For example, in the letter from Democratic members of Congress, the signatories asserted,

In total, the study conducted by the CFPB at Congress's request roundly confirms that individuals unknowingly sign away their rights through forced arbitration agreements, which do not reduce consumer costs for financial services. . . . Based on this substantial bedrock of evidence, we urge the CFPB to move forward quickly to use its authority under the Dodd-Frank Act to issue strong rules to prohibit the use of forced arbitration clauses in financial contracts and give consumers a meaningful choice after disputes arise.²⁵

Critics of arbitration agreements make a number of stylized, oft-repeated criticisms of arbitration.²⁶ Some critics, such as the California Supreme Court,²⁷ object to arbitration clauses contained in what they call *adhesion contracts*, by which they mean contracts whose terms (including arbitration terms) were not and probably could not be subject to consumer bargaining. Other critics argue that arbitration proceedings are unfair and tilted against consumers and that

²⁴ For works by one especially dedicated scholar, see Myriam Gilles, *Killing Them with Kindness: Examining Consumer-Friendly Arbitration Clauses after AT&T Mobility v. Concepcion*, 88 NOTRE DAME L. REV. 825 (2013); Myriam Gilles, *Opting out of Liability: The Forthcoming, Near-Total Demise of the Modern Class Action*, 104 MICH. L. REV. 373 (2005).

²⁵ Letter from Franken et al., *supra* note 12, at 2.

²⁶ Jean R. Sternlight, *Creeping Mandatory Arbitration: Is It Just?*, 57 STAN. L. REV. 163 (2005); Theodore Eisenberg et al., *Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts*, 41 U. MICH. J.L. REFORM 871 (2007–2008); Miles B. Farmer, *Mandatory and Fair: A Better System of Mandatory Arbitration*, 121 YALE L.J. 2346 (2011–2012).

²⁷ *Discover Bank v. Superior Court*, 36 Cal. 4th 148, 162–163, 113 P. 3d 1100, 1110 (2005).

arbitration effectively annihilates many consumer claims.²⁸ Still others argue that given the small size of the claims at stake in many disputes, it is not financially feasible for consumers to bring arbitration actions to vindicate their rights.²⁹ Finally, critics of consumer arbitration often point to class action litigation as their preferred method for resolution of consumer disputes.

III. The CFPB Report: Summary and Critique

In December 2013, the CFPB produced the preliminary results of its study of arbitration in consumer financial products contracts. More than a year later, in March 2015, the CFPB released its final arbitration study, *Arbitration Study: Report to Congress 2015*. The Report expands on the findings in the preliminary results. More generally, it presents entirely new material, so that the preliminary results (which according to the CFPB stand “as presented there”) and the Report together constitute the CFPB’s report to Congress on arbitration.³⁰ Hence, in this paper, we discuss components.³¹

For both versions of its arbitration study, the CFPB was given access to actual American Arbitration Association (AAA) consumer arbitration files. According to the CFPB, it was given access to the AAA consumer arbitration files only under a confidentiality restriction. Although the AAA makes data about its consumer arbitrations available publicly online, the publicly available data do not include all of the information that is contained in the actual arbitration case

²⁸ See Sternlight, *supra* note 1; Jean R. Sternlight, *Tsunami: AT&T Mobility LLC v. Concepcion Impedes Access to Justice*, 90 OR. L. REV. 703 (2012).

²⁹ David Korn & David Rosenberg, *Concepcion’s Pro-defendant Biasing of the Arbitration Process: The Class Counsel Solution*, 46 U. MICH. J.L. REFORM 1151 (2013).

³⁰ The CFPB’s explanation of the relationship between the Report and the preliminary results appears at page 9 of section I of the Report.

³¹ When we refer simply to the CFPB’s Report or the Report, we are referring to the final arbitration study: CONSUMER FIN. PROT. BUREAU (CFPB), *ARBITRATION STUDY: REPORT TO CONGRESS 2015* (2015). We will by contrast refer to the preliminary results study of December, 2013, as just that: the preliminary results report, CFPB *ARBITRATION STUDY: PRELIMINARY REPORT* (2013).

files. Thus, in its arbitration study, the CFPB had a unique opportunity to expand what is known about consumer arbitration.

In its 2015 Report, the CFPB reported on what it had learned about AAA arbitrations involving credit cards, checking accounts, payday loans, prepaid cards, auto purchase loans, and private student loans. After releasing the 2013 preliminary results, the CFPB added private student loan and automobile loans to its 2010–2012 arbitration dataset. This addition was not trivial: student and auto loan arbitrations make up 31% of the arbitrations covered by the 2015 Report.³²

One of the most interesting general findings in the CFPB's research into AAA arbitration of disputes involving these six products is that arbitrations involving some of the products typically concern a dispute as to the debt amount, but those involving other products rarely concern such a dispute. With its access to actual AAA arbitration files, the CFPB was able to discern that in arbitrations with affirmative consumer claims for relief, the consumer is typically disputing the amount of a debt that is being collected outside arbitration.³³ The CFPB further found that consumers often dispute the debt amount by way of defense in an arbitration action.

³² CFPB (2015), *supra* note 9, section 5, at 20.

³³ In the body of the preliminary results report, the CFPB explained that it “counted mutual submissions and consumer filed disputes as debt collection arbitrations when the case included a substantive debt dispute and the arbitration record shows that there was a prior court proceeding as to which the consumer invoked arbitration.” CFPB (2013), *supra* note 8, at 66. The CFPB further explained that “there were a number of pleading formats in consumer-filed and mutually submitted AAA arbitrations . . . that persuaded us that the debt collection category needs to be broadened in this way. In some cases, for example, the consumer may affirmatively state that he or she has no claims but wants the arbitrator to resolve the merits of the company's underlying debt collection claim. In others, the consumer states that he or she is filing the arbitration demand instead of filing an answer to a collection claim in court, or the consumer may file an arbitration for declaratory judgment that he or she does not owe the amount claimed by the company. . . . In some respects, however, we may have undercounted debt collection arbitrations in our total pool of cases. Our definition relies on an indication in the arbitration record of prior court proceedings. The arbitration record may not contain that indication, even when there was, in fact, a prior collection action in court. In addition, even when a company has not yet sued in court to collect debt, it is possible that some consumers are preemptively filing arbitrations to challenge the company's pre-judicial assertion of a debt. In fact, a substantial number of the ‘non-debt collection’ credit card arbitrations in our review appeared to involve only a substantive debt dispute and no non-debt claims at all, even though the arbitration may be filed by a consumer. . . . [W]e opted to use objective rules to define debt collection arbitrations, rather than trying to assess whether the weight of the arbitration record indicated that collection activity was already underway before a substantive dispute reached arbitration. But it is important to bear in mind that our ‘non-debt collection category’ included a large number of cases in which debt was at issue.” CFPB (2013), *supra* note 8, at 67–68.

The fraction of arbitrations in the CFPB's dataset involving a dispute over the debt amount varies from 98% of student loan arbitrations and 87% of credit card arbitrations to 11% of payday loan arbitrations and 3% of checking account arbitrations.³⁴ The variation in the frequency with which different types of arbitrations involve disputed debt amounts does not seem to be explained by whether the company initiated arbitration—debts were very often disputed for both credit card and student loan arbitrations, but companies initiated 54% of credit arbitrations and only 2.8% of student loan arbitrations.

As the CFPB explained in its 2013 preliminary results, in 2009 the AAA self-imposed a moratorium on debt collection actions filed by businesses.³⁵ That moratorium remains in place in 2015. However, the AAA will arbitrate a debt collection issue raised by either the consumer or the business in an arbitration filed by a consumer (or when the consumer consents in writing to arbitration of a debt collection) and will arbitrate a debt collection action in a case that the court has ordered to be arbitrated.³⁶

One thing that the CFPB Report may help explain is why the AAA seemed more than happy to self-impose its moratorium on hearing AAA debt collection arbitrations filed by businesses. Even under the CFPB's rather broad definition of a *debt collection arbitration*, the CFPB found only 522 debt collection actions over the 2010–2012 period, and all but 4 of these actions involved credit card disputes.³⁷ By contrast, in 2012 alone, the small claims court in Philadelphia County, Pennsylvania, had more than 2,200 debt collection cases.³⁸ That the number of debt collection actions pursued in court is almost an order of magnitude greater than

³⁴ CFPB (2015), *supra* note 9, section 5, at 26. The report does not provide frequencies; those are computed here.

³⁵ CFPB (2013), *supra* note 8, at 65.

³⁶ *Id.* at 66.

³⁷ CFPB (2015), *supra* note 9, section 4, at 92.

³⁸ *Id.*

the number pursued by arbitration makes clear that AAA arbitration is a relatively insignificant institution of consumer debt collection.

In its 2013 preliminary results, the CFPB presented data on three main aspects of consumer arbitration: (a) the claimed amount, (b) the frequency with which consumer claimants have legal representation, and (c) the substantive legal basis of consumer claims. To this list, the 2015 Report added two main types of data on arbitrations: (a) outcomes in cases that reached final resolution by an arbitrator, as well as basic statistics on how outcomes varied depending on what the substantive basis of the consumer's claim was and whether the consumer had representation, and (b) some data on the arbitration process, such as how long it took to get a final arbitrator decision, and data on consumers who changed the amount claimed during the arbitral process. Perhaps the most important part of the 2013 preliminary results report was its comparison of the number of small claims consumer arbitrations with the results of a selected sample of consumer class action litigations. The 2015 Report significantly adds to the CFPB's comparison of arbitration cases to class action cases by presenting extensive data on what kinds of claims are brought as consumer class actions and on the settlements in such cases. It also provides some data allowing comparison of the kinds of cases brought as class actions with those brought as individual actions. Thus, in many ways, the heart of the CFPB's combined 2013 preliminary results and 2015 Report is a quite detailed comparison of the results in consumer class actions with the results in consumer AAA arbitrations. We argue in this paper that, for a number of reasons, this comparison cannot be taken as indicating the superiority of either class actions or consumer arbitrations, although the CFPB's comparison of the two approaches is clearly the most detailed yet produced.

Three other aspects of the CFPB's Report deserve mention. Two of those elements are directly related to the general comparison of class actions and arbitration: a survey of consumers that seeks to identify what consumers know about arbitration, class actions, and other methods of dispute resolution and an econometric study of whether arbitration leads to lower prices for consumers. We comment on these aspects in detail later in this paper.

Furthermore, although the CFPB focused mainly on comparing different methods of ex post dispute resolution, it also reported on the frequency with which consumer contracts in various product markets contain mandatory arbitration clauses and on the various features of such mandatory arbitration clauses, such as whether the clauses waive class relief. We also comment in some detail on this aspect of the Report.

We do not comment on some relatively short sections of the Report that examine the role of small claims courts in consumer dispute resolution and the relationship between public enforcement actions and consumer class actions. Looking at online small claims court databases for which states offered free or low-cost access to case information, the CFPB was able to obtain systematic case document information for only two state small claims courts, those in Alameda County, California, and Philadelphia County, Pennsylvania. The CFPB found essentially what other researchers have found previously:³⁹ that there is considerable variation across states in small claims courts procedures, with some states adopting procedures that tend to discourage businesses from using small claims courts to pursue cases against consumers and other states having procedures (such as venue rules) that have encouraged business to pursue debt collection and other actions against consumers in small claims court. As for public enforcement actions, the CFPB addressed the question of the extent to which private class actions merely piggyback off

³⁹ See Richard Hynes, *Broke but Not Bankrupt: Consumer Debt Collection Actions in State Court*, 60 FLA. L. REV. 1 (2008).

previously adjudicated public enforcement actions. Looking at all large-dollar (\$10 million or more) class action settlements plus a sample of other class action settlements, the CFPB found that only a relatively small fraction, 12%, of private consumer class actions were filed after public enforcement actions dealing with the same issues. Because there is no widespread perception that consumer class actions merely duplicate and piggyback public enforcement, this finding is essentially a null result in terms of the larger policy debate.

IV. CFPB Findings That Undercut Arguments That Arbitration Is Unfair to Consumers

The CFPB Report is useful in providing data—much of it for the first time—with respect to many of the claims typically made about arbitration. Somewhat surprisingly, however, some of the CFPB’s findings tend to *rebut* the hypotheses of arbitration’s critics. Moreover, where the data do not undermine arguments for restricting arbitration, they are subject to serious drawbacks that limit the usefulness of the data for supporting restrictions on consumer arbitration.

A. Do Consumers Have Meaningful Choice Regarding Whether to Enter into Contracts That Contain Arbitration Clauses?

One criticism of arbitration clauses in consumer credit contracts is that such contracts are “contracts of adhesion,” such that consumers have no meaningful choice but to accept the terms.⁴⁰ It is implied that with respect to most so-called contracts of adhesion, the terms of the contracts offered by virtually every financial institution are identical on this point; thus, the consumer cannot avoid the clause by dealing with a different financial institution.

Yet one of the most important contributions of the CFPB Report is to demonstrate that such an assumption may be untrue when it comes to consumer credit. For example, the CFPB

⁴⁰ See CFPB (2015), *supra* note 9, section 1, at 4, n.4.

data show that although there has been a slight increase in use since the Supreme Court made clear that state courts may not invalidate mandatory arbitration clauses in consumer contracts on public policy grounds,⁴¹ the vast majority (84%) of credit card issuers do not use such mandatory arbitration clauses. Arbitration clauses are used more often by larger card issuers.⁴² With respect to checking accounts, mandatory arbitration clauses are even less common; the CFPB found that only 8% of banks include arbitration clauses in their checking account contracts. Thus, for checking and credit card accounts, consumers can quite easily avoid contracts with mandatory arbitration if they choose to do so.

Even in contracts in which arbitration clauses are most common—prepaid cards, where 92% of the contracts studied included mandatory arbitration clauses—providers accounting for about 17% of the market do not contractually require arbitration.⁴³ That statistic suggests that consumers who dislike arbitration can find prepaid card providers that do not require that form of dispute resolution.⁴⁴

The only market in which the CFPB found that virtually all (99.9%) consumers are bound by mandatory arbitration was the market for mobile wireless service. Mobile wireless contracts were not studied by the CFPB in its 2013 preliminary results, and their inclusion in the 2015 Report is puzzling. The CFPB says that it included mobile wireless contracts in its 2015 Report because the major wireless providers allow consumers to charge payments for goods and

⁴¹ *AT&T Mobility v. Concepcion*, 563 U.S. 321 (2011).

⁴² CFPB (2015), *supra* note 9, section 2, at 7, 9–12. One possible explanation for the distinction between larger and smaller credit card issuers is that larger issuers may be especially prone to large nuisance class actions simply because of their size; thus, to avoid such litigation, they may find arbitration especially valuable.

⁴³ *Id.*, section 2, at 8.

⁴⁴ Indeed, in light of the relative ease with which consumers of prepaid cards (as opposed to credit cards and bank accounts) can and do switch from one prepaid card to another, if consumers valued an arbitration-free contract, they could likely adopt such a card without difficulty. See Todd J. Zywicki, *The Economics and Regulation of Network-Branded Prepaid Cards*, 65 FLA. L. REV. 1477 (2013).

services to their wireless bills, a practice known as *mobile wireless third-party billing*.⁴⁵ In the developing world, where many consumers have neither credit cards nor bank accounts, mobile wireless third-party billing is apparently a rapidly growing market.⁴⁶ In the United States, mobile wireless third-party billing has been a tiny share of the market, and even in the future it will likely be used only to pay for smartphone apps.⁴⁷ The actual market significance of mandatory arbitration for mobile wireless billing depends on the future importance of mobile wireless billing and may not be indicated by the share of the wireless market taken by wireless firms that require arbitration. Disputes under mobile phone contracts appear to have little more to do with financial services than does the purchase of any other ordinary goods or services; thus, the findings with respect to mobile wireless service cannot easily be generalized to other consumer financial services.

As we discuss later in this paper, the CFPB also found that most consumers do not pay much attention to whether their credit card contract has a mandatory arbitration clause. This finding might be taken to imply that even if consumers could, in theory, shop among card providers on the basis of whether they require arbitration, in practice, firms would not be influenced by consumer shopping in determining whether to require arbitration. Not only is that implication unjustified, but so too is the entire premise—made not just by the CFPB Report but by the literature preceding it—that for arbitration to benefit consumers, consumers must observe and shop among contract clauses that specify the method by which ex post disputes with the firm will be resolved.

⁴⁵ CFPB (2015), *supra* note 9, section 2, at 25–26.

⁴⁶ Mondato, *The Re-emergence of Carrier Billing*, LATEST INSIGHT BLOG (Sept. 24, 2014), <http://mondato.com/blog/carrier-billing/>.

⁴⁷ FED. TRADE COMM'N, MOBILE CRAMMING: A FTC STAFF REPORT 4–5 (July 2014), *available at* <https://www.ftc.gov/system/files/documents/reports/mobile-cramming-federal-trade-commission-staff-report-july-2014/140728mobilecramming.pdf>.

To understand why that impression is mistaken, note that as we also discuss later, the CFPB found that consumers do consider terms such as what interest rate is offered and whether firms fairly resolve consumer complaints. Indeed, the CFPB reports that the vast majority of consumers respond to firms that do not fairly resolve complaints by canceling their cards with the firms. A firm's required method of ex post dispute resolution is not something that consumers specifically consider while shopping, but the matters that consumers do consider—prices and how firms resolve complaints—are likely directly influenced by whether a firm can require arbitration. If by requiring arbitration a firm reduces its expected costs of ex post dispute resolution and increases the benefits of accuracy in internal dispute resolution (meaning, it grants consumers a refund when the firm really has made a mistake and denies refunds when no mistake has been made), then arbitration reduces the firm's costs while increasing its payoff to investing in internal dispute resolution. Arbitration's likely influence is under the hood, as it were, but potentially it is just as great as if consumers did shop directly considering arbitration clauses.

B. Is Arbitration Fair to Consumers?

A second criticism of arbitration is that it is unfair to consumers. The unfairness is allegedly both substantive, in that consumers fare worse in arbitration than they do in litigation, and procedural, in that consumers lack legal counsel when they pursue arbitration claims. The CFPB arbitration study casts significant doubt on the validity of both criticisms.

1. The CFPB arbitration study reports surprisingly high rates of legal representation in consumer AAA arbitrations. The CFPB arbitration study clearly shows that representation is not a problem for consumers in most types of AAA consumer arbitrations. For all product markets

combined, consumers were represented by counsel in 63% of arbitration cases.⁴⁸ For payday and student loan arbitrations, consumers have counsel in 95% of the cases, and for checking account disputes, 56% of the cases. Even in credit card arbitrations—the only important type of AAA consumer arbitration in which consumers did not have counsel in the majority of cases—consumers still were represented by counsel in 47% of the cases. Importantly, in credit card cases in which consumers disputed the debt amount, they were represented by counsel 70% of the time.⁴⁹

In section 6 of the Report, the CFPB implicitly compares the representation rates in arbitration with representation rates in individual and class action litigation filed in federal court. Unsurprisingly, class counsel were present in all class actions studied by the CFPB (except, apparently, one), and individual plaintiffs had representation in about 94% of the individual federal actions.⁵⁰

2. The CFPB report also shows that unrepresented consumers have relatively high success rates in AAA arbitration, so that legal representation is not as important in AAA arbitration as in state and federal court litigation. The problem with the CFPB's implicit comparison is that it does not in any way control for the relative value of representation to a plaintiff in federal court versus a claimant in consumer arbitration proceedings. Representation is valuable in federal court because civil procedure is complicated and the costs of pursuing a claim are high. Pro se—or as they are now called, self-represented—plaintiffs in civil federal lawsuits of all types are only 4% in the CFPB's large sample of cases. For a federal plaintiff to reach the point at which settlement is even on the table, let alone to get to a substantive trial on the merits, he or she has to successfully

⁴⁸ CFPB (2015), *supra* note 9, section 5, at 29.

⁴⁹ *Id.*, section 5, at 30.

⁵⁰ *Id.*, section 6, at 22–23.

serve process, manage to file a complaint that can withstand increasingly tough pleading standards and the inevitable failure to state a claim motion, and then do enough discovery to get past a summary judgment motion. Few self-represented plaintiffs succeed in overcoming those federal court hurdles.

Oddly, the CFPB reports both on the AAA arbitration procedures that apply to the cases it actually studies and on the JAMS procedures, which are irrelevant to AAA arbitrations. However, under the AAA consumer arbitration procedures that actually apply to the cases studied by the CFPB, all consumers have to do to initiate an arbitration is to file a claim describing the dispute and the business that they are disputing against, specify where they would like the arbitration hearing to happen if they want a hearing, and attach a copy of any arbitration agreement. Since 2013, the consumer has had to pay only a \$200 fee administrative fee to the AAA, with all remaining fees paid by the company and the \$200 fee waived for any consumer whose income is less than two times the federal poverty level. The AAA chooses the arbitrator from its National List of Arbitrators, and then the arbitrator makes a decision. Essentially, none of the complex procedural motions found in federal court are permitted in arbitration, and for claims under \$10,000, the arbitrator's decision is by default based only on the documents submitted or, in some cases, on a telephone hearing held. Only for claims above \$10,000 is an actual hearing before an arbitrator the default way of resolving the dispute. If a hearing is held, it must be in a location convenient for the consumer.

At 26 pages, section 4 of the Report, on how arbitration procedures differ from procedures in court, is one of the shortest sections in the entire study. Importantly, the CFPB makes no attempt in the section to estimate the actual transaction costs that a consumer would face in pursuing an individual claim in federal court rather than in arbitration. Nor does it attempt

to estimate the actual ability of a consumer to pursue a self-represented claim in federal court. However, it is worth noting that what is essentially the entire procedural requirement for an arbitration consumer—filing a claim with the arbitration agreement attached that states the basic facts of the claim—is just the first step in federal court. That first step itself has detailed legal requirements attached to it—requirements that can cause dismissal with prejudice if not followed. It would seem that even if representation is valuable to consumers in arbitration, the AAA arbitration procedures at least allow for the possibility that an unrepresented consumer claimant may succeed. Without considering both the costs and the benefits of litigation proceedings, of course, it is impossible to say whether consumers would be better off being forced to litigate instead of arbitrate.⁵¹

That the AAA consumer arbitration procedure is much simpler and less costly than federal court litigation is strongly suggested by CFPB findings showing that arbitrations are resolved very quickly. The Report finds that even when telephone hearings were conducted, most arbitrations were resolved in less than five months, and even with a hearing, most were resolved in less than seven months. When there was a known settlement, it usually was achieved in about five months.⁵²

Moreover, the CFPB also found that hiring an attorney is far from crucial to consumers in AAA arbitration. On the one hand, at relative frequencies of 40% versus 34%, consumers with representation more often got settlements than those without attorneys. On the other hand, at relative rates of 2% versus 14%, consumers with attorneys did much worse in cases that actually

⁵¹ We follow the standard conclusion of arbitration experts that for arbitration to be viable, it must be a mandatory pre-dispute clause. Otherwise, the use of arbitration would unravel because of standard forum-shopping problems as consumers decided whether to sue or to arbitrate on the basis of the forum that they thought most advantageous for their claim.

⁵² CFPB (2015), *supra* note 9, section 5, at 72.

ended in a decision by the arbitrator.⁵³ Thus, the arbitration study shows that self-represented plaintiffs were seven times more likely than represented plaintiffs to get an AAA arbitrator's decision in their favor. That finding is consistent with arbitration's being a process set up so that hiring an attorney offers little value to a consumer and is often unnecessary.

As noted earlier, the CFPB arbitration study reports that 94% of individual plaintiffs in its sample of federal and state court consumer lawsuits were represented by attorneys. By far the most important type of individual suit pursued on a self-represented basis involved a checking account or debit card. In such suits, 68% of plaintiffs were self-represented.⁵⁴ Surprisingly, given the finding that self-representation is actually the rule rather than the exception in individual lawsuits involving checking accounts and debit cards, the CFPB study fails to report on how outcomes in individual consumer lawsuits varied between those brought by consumers with counsel and those brought by consumers who were self-represented.

The CFPB reports that consumers who *did* have counsel in individual consumer lawsuits obtained judgments in their favor about 7% of the time, with settlements occurring somewhere in the range of 42% to 48% of all cases filed, depending on whether one counts known or "potential" settlements.⁵⁵ The CFPB reports that over the entire set of 668 arbitrations in which it coded consumers as making an affirmative claim for relief, consumers received awards in 20% of the 158 arbitrations that the CFPB determined to have ended in an arbitral award, or 6% of the total number of such arbitrations.⁵⁶ Yet the CFPB also reports that of all 1,060 arbitrations in its sample (not just those in which consumers made affirmative claims for relief), 57% either were

⁵³ *Id.*, section 5, at 55. The rates in the text are derived from figures 11 and 12.

⁵⁴ *Id.*, section 6, at 32.

⁵⁵ *Id.*, section 6, at 48.

⁵⁶ *Id.*, section 5, at 41.

known to have settled or were “consistent with settlement.”⁵⁷ Thus, with 57% of all arbitrations resulting in settlement and 6% in an award for a consumer claimant, arbitration seems to generate *comparable or even slightly better results* for individual claimants than do individual consumer lawsuits (where up to 48% result in settlements and 7% in consumer judgments).

Note that the CFPB found a much lower rate of consumer success in AAA arbitrations than previously reported in the pathbreaking study of AAA arbitration by Christopher Drahozal and Samantha Zyontz. Drahozal and Zyontz studied 301 AAA consumer arbitration cases heard in 2007 and found that consumers won some relief in 53.3% of arbitrations.⁵⁸ Moreover, consumers recovered attorneys’ fees in 63% of cases in which they sought fees.⁵⁹ The CFPB finding that unrepresented consumers in AAA arbitration are much more likely to prevail on the merits than are represented consumers in lawsuits filed in court is consistent with the earlier finding by Drahozal and Zyontz that, at least in some types of cases, consumers win *more* frequently in arbitration than in court.⁶⁰

The large disparity between the consumer AAA arbitration success rates reported by the CFPB (20% for consumers making affirmative claims) and by Drahozal and Zyontz (53%) suggests that further work needs to be done with AAA consumer arbitration files. In any event, the data that the CFPB has reported in its 2015 study is not consistent with the claim that arbitration yields worse outcomes for consumers. As it stands in its now presumably final form, the CFPB Report suggests, to the contrary, that AAA arbitration may be the *only* forum in which unrepresented consumers have a chance to obtain a decision in their favor.

⁵⁷ *Id.*, section 5, at 32.

⁵⁸ Christopher R. Drahozal & Samantha Zyontz, *An Empirical Study of AAA Consumer Arbitrations*, 25 OHIO ST. J. DISP. RESOL. 843 (2010).

⁵⁹ *Id.*

⁶⁰ Christopher R. Drahozal & Samantha Zyontz, *Creditor Claims in Arbitration and in Court*, 7 HASTINGS BUS. L.J. 77 (2011).

V. Understanding the Effect of Arbitration Clauses: The Irrelevance of the CFPB's Findings

In the 2015 Report, the CFPB expanded the scope of its inquiry into the effect of arbitration clauses for consumers. One new section (section 10) purports to be a statistical (or econometric) analysis of whether mandatory arbitration clauses lower prices for consumers. Another new section (section 3) presents the results of a survey that probed whether consumers know whether they are bound by mandatory arbitration clauses. Neither set of results can be taken as disconfirming the benefits of arbitration to consumers. The CFPB's finding that a temporary moratorium on the use of arbitration clauses by some credit card issuers did not significantly affect pricing relative to that of issuers without such a moratorium just confirms that financial products providers, like firms generally, do not change prices in response to temporary cost changes, nor does the CFPB provide any explanation as to why it thinks otherwise. The Report shows nothing that indicates whether arbitration benefits consumers by lowering prices. The CFPB's survey of consumers found that consumers know little about ex post dispute resolution mechanisms—whether arbitration or class actions. However, the CFPB's survey also revealed why such relative ignorance is perfectly rational: when they feel that a credit card firm has wrongfully imposed a fee or charge that it refuses to reverse, consumers overwhelmingly prefer the market response of canceling their cards over litigating or arbitrating the dispute.⁶¹

A. *Why Consumers Don't Need to Know Much about Arbitration Clauses*

In section 3 of the Report, the CFPB provides the results from a survey that asked about a thousand credit card owners a number of questions about their choice of a credit card and about

⁶¹ As discussed later in the next subsection, the CFPB reports that faced with a situation in which a credit card company was imposing a charge that the consumer had not signed up for, 57% of the survey respondents said they would cancel their card (the market response), whereas only 1% said they would seek legal advice or sue using an attorney. See CFPB (2015), *supra* note 9, section 3, at 18.

whether they would pursue a complaint against a credit card company through an external dispute resolution mechanisms such as litigation or arbitration if the company failed to resolve their claim internally. In answering an open-ended question of the form, “Why did you choose the card you did?,” a relatively small fraction of respondents came up with a particular reason. The most frequently given responses to this open-ended question were the interest rate on the card and the card’s rewards program. When various credit card features were asked about specifically (the closed-end format), most respondents indicated that the interest rate, customer service, rewards, fees, issuer’s reputation, and card acceptance all were factors that entered into their decision to get a particular card.⁶²

As for knowledge about and willingness to pursue external dispute resolution, the CFPB survey found that even if consumers were charged a fee that they knew the company had incorrectly assessed, only 1.4% of respondents said they would seek legal advice and an even smaller 0.7% said they would consider initiating legal proceedings. A similarly small percentage of consumer respondents, 1.7%, said that they would simply pay the fee. As for arbitration clauses, consumers seemed to have little understanding of whether their credit card contract contained such a clause and whether the clause prevented them from taking a dispute to court. Regardless of what the contract actually said, about 20% of consumers thought that their contract included such a clause and about 7% of consumers thought that they could not sue in court, regardless of whether their contract had a mandatory arbitration clause. Most consumers with a mandatory arbitration clause (57%) still thought that they could participate in a class action lawsuit.⁶³

⁶² *Id.*, section 3, at 14.

⁶³ *Id.*, section 3, at 3.

The CFPB highlights its final set of findings by placing it in the first paragraph summarizing the results of its survey: the relative ignorance of consumers regarding whether their credit card contract has a mandatory arbitration clause and the effect of such a clause on their right to file suit. However, the CFPB's survey clearly shows that consumers do care about many features of their cards, such as the interest rate and whether the card has a rewards program. It also shows that consumers care intensely about whether credit card companies remove incorrectly assessed fees and charges. As noted previously, the survey found that 57% of respondents said that they would cancel their cards if a company incorrectly assessed a fee and failed to remove it in response to a consumer complaint. Only 1% would seek legal advice or sue using an attorney. The survey thus found that consumers prefer the market to the legal response for perceived service failures by a credit card company. When a company does not resolve a dispute internally to the customers' satisfaction, consumers take their credit card business elsewhere.

The CFPB's survey provides strong evidence of the credibility of the threat posed by consumers to take their business elsewhere if a credit card company does not reverse mistaken fees and charges. Savvy consumers know that if they have a long and profitable relationship with a financial services provider, the provider is very likely to waive various fees to keep them happy and to keep their business. A classic example of such business-motivated forgiveness of fees occurs when a credit card issuer waives the late fee and interest payment imposed when a credit cardholder with a good record of making payments on time happens to be a bit late once in making a payment. Another example is when a provider waives a fee that it has indeed mistakenly assessed. The provider may have inadvertently placed individual social security number information in a location on a document where it is visible to third parties or had a

malfunctioning ATM terminal. In such cases, the provider may itself take corrective action, such as providing free credit monitoring (in the social security number case) or reversing charges for disputed transactions (in the ATM malfunction case).

The assumption by consumers that firms will work to retain their business turns out to be reasonable. To understand the propensity of financial institutions to resolve customer disputes internally, we were able to examine data provided by a mid-sized regional bank in Texas with respect to its internal processes for resolving disputes. According to this bank, a consumer complaint about a fee that was charged initiated an internal review process within the bank that analyzed refund requests on a case-by-case basis. During 2014, the process undertaken by the bank resulted in its refunding 94% of wire transfer fees that customers complained about at its San Antonio office and 75% of wire transfer fees that customers complained about at its Brownsville office. During that same period, the bank responded to complaints about inactive account fees by making refunds 74% of the time in San Antonio but only 56% of the time in Houston. Refunds varied among products as well: the bank rarely granted refunds of ATM fees but routinely granted refunds of overdraft fees, inactive account fees, and others.

The variation in bank refund rates by location and product strongly suggests that customer value maximization and not minimization of the risk of class action litigation was the driving force behind this bank's refund decisions. Especially in the largest class actions, such as the bank overdraft fee settlements discussed later in this paper, class litigation is typically premised on a firmwide practice. If fear of such litigation were driving bank refund practices, one would not expect to see wide variation across products and branch locations. Variation is precisely what one would expect to see if refunds were based on individualized

determinations of the validity of the consumer's complaint and on the value of keeping a consumer's business.⁶⁴

Overall, the bank offered refunds in about 68% of cases in which a consumer complained, resulting in refunds of over \$2.275 million in 2014. Such a high refund rate explains what the CFPB leaves unexplained: why consumers do not know much about external dispute resolution mechanisms such as class actions and arbitration but do know that they will take their business elsewhere if a credit card issuer fails to internally resolve a valid complaint. There is evidence that credit card issuers, like the Texas bank, reverse fees and charges on an individualized basis, depending on a particular cardholder's history with and value to the issuer.⁶⁵ Credit card issuers have every incentive to respond to valid complaints brought by their cardholders precisely because consumers do what they told the CFPB they would do: terminate a card when the issuer does not respond. Given the effectiveness of this market response, consumers do not need to know anything about the details of the potential legal response they might have available when a company declines to refund charges and fees, and they have no reason to assume that being required to arbitrate rather than litigate would be an important reason to select one card over another.

B. Why the CFPB's Econometrics Are Flawed and Not So Harmless

One of the traditional arguments in favor of mandatory arbitration clauses in consumer contracts is that if arbitration lowers costs for financial product providers, consumers will benefit, because the lower costs are passed on to consumers in the form of lower prices. In section 10 of its

⁶⁴ That such determinations may sometimes involve the exercise of discretion by middle-level managers does not make them any less motivated by the firm's incentive to retain valuable customers. Indeed, such discretion may allow for more accurate determination of customer-specific value.

⁶⁵ See Jason Scott Johnston, *The Return of Bargain: An Economic Theory of How Standard-Form Contracts Enable Cooperative Negotiation between Businesses and Consumers*, 104 MICH. L. REV. 857 (2006).

Report, the CFPB took the settlement in an antitrust case, *Ross v. Bank of America*,⁶⁶ as a natural experiment shedding light on whether, in fact, arbitration clauses do lead to lower prices for consumers. Under the settlement in *Ross*, a subset of four defendants agreed to stop using arbitration clauses for at least three and a half years. The CFPB looked at whether the change in the total cost of credit charged to consumers after the imposition of the settlement terms differed between the credit card issuers who stopped using arbitration clauses under the settlement and a large (although not precisely identified) set of issuers not subject to the settlement. The CFPB found no statistically significant difference in the change in the cost of credit across the two groups after one group stopped using arbitration clauses.⁶⁷

Basic economic theory predicts that competition forces firms to pass on to consumers at least a portion of any cost decrease. As an empirical matter, evidence shows that financial products firms do pass on changes in their costs, as, for example, when debit card issuers passed on price controls on debit card interchange fees in the form of higher bank fees for consumers.⁶⁸ However, financial economists have long known that banks do not adjust their deposit and loan rates quickly or fully to temporary changes in market interest rates. Recent work indicates clearly that to explain bank pricing, one needs to take account not only of current and recent values of factors such as money market rates but also of expected future rates.⁶⁹ More generally, it is known that firms in the consumer services sector adjust prices much more slowly in response to

⁶⁶ No. 05-Civ. 7116 (S.D. N.Y.).

⁶⁷ CFPB (2015), *supra* note 9, section 10, at 15.

⁶⁸ David S. Evans, Howard Chang & Steven Joyce, *The Impact of the U.S. Debit Card Fee Regulation on Consumer Welfare: An Event Study Analysis* (U. CHI. COASE-SANDOR INST., Research Paper No. 658, 2013), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2342593; Todd Zywicki, Geoffrey Manne & Julian Morris, *Price Controls on Payment Card Interchange Fees: The U.S. Experience* (ICLE FIN. REG. RES. PROGRAM, White Paper 2014-2, 2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2446080.

⁶⁹ See Kenneth J. Kopecky & David D. Van Hoose, *Imperfect Competition in Bank Retail Markets, Deposit and Loan Rate Dynamics, and Incomplete Pass Through*, 44 J. MONEY, CREDIT & BANKING. 1185 (2012).

cost changes than do firms in the manufacturing sector and that large firms adjust prices more slowly than do small firms.⁷⁰

In light of what economists have learned about how firms adjust prices to cost changes, it is hardly surprising that the CFPB found that the four credit card issuers that agreed to remove arbitration clauses for three and half years did not change their credit card prices in a way that significantly differed from the practices of other issuers. Even if the arbitration clause moratorium increased the costs to the subject firms, the moratorium was only temporary. There is neither theoretical nor empirical reason to have thought that such a temporary change in costs would change credit card pricing. Moreover, the CFPB looked at whether prices changed differentially during the year after the arbitration moratorium was imposed. Again, no evidence indicates that financial services prices respond so quickly even to a permanent change in costs and no sound theoretical reason exists to think that they would.

In addition to these theoretical problems, there are technical failures with the CFPB's econometric study of whether credit card firms that removed arbitration clauses changed prices at a different rate than firms that did not. Perhaps most importantly, the Report fails to indicate whether the CFPB checked to ensure the validity of the econometric technique it used. The technique—which compares the change in prices in the treatment group (the companies subject to the arbitration clause moratorium) to the change in prices in the control group (the companies still using arbitration clauses)—is valid only if prices in the two groups of companies had been changing at the same rate before the imposition of the moratorium. Only if this were true (so-called parallel paths) could one say that any change in prices among the companies not subject to

⁷⁰ See Daniel A. Dias, Carlos Robalo Marques, Fernando Martins & J.M.C. Santos Silva, *Understanding Price Stickiness: Firm-Level Evidence on Price Adjustment Lags and Their Asymmetries*, OXFORD BULL. ECON. & STAT. (2014).

the moratorium would be a good proxy for how prices would hypothetically have changed among companies subject to the moratorium.⁷¹ Nothing in the report indicates that the CFPB checked for parallel paths.

In contrast, concrete case study evidence shows at least one example in which consumers who were willing to accept a contract that included an arbitration clause were offered a lower interest rate than those who insisted on the right to litigate disagreements.⁷² Especially in light of this evidence and the theoretical and econometric problems with the CFPB's study of arbitration clauses and credit card prices, it is clear that much more careful empirical work needs to be done before conclusions can be made about the potential pass-through to consumers of cost savings from arbitration.

VI. Arbitration and Class Actions Compared

As we have explained, the major concern that courts have had with mandatory arbitration clauses in consumer contracts is that such clauses typically preclude class action lawsuits. Courts that have invalidated such arbitration clauses on public policy grounds have found that class actions are necessary for consumers to be adequately compensated and for firms to be deterred from practices causing widespread but small consumer harm. The CFPB's arbitration study attempts to inform this debate by providing some evidence on the outcomes that consumers receive under arbitration versus recoveries in class action suits. Unfortunately, although the CFPB's arbitration reports do provide new data on both class actions and arbitration, they do little to inform the public policy debate. Although the CFPB finds that few arbitration cases involve claim amounts

⁷¹ Actually there are other assumptions implicitly made by the difference-in-difference approach, but this one is the most basic to the validity of the estimates. See Ricardo Mora & Ilana Reggion, *Treatment Effect Identification Using Alternative Parallel Assumptions* (UNIVERSIDAD CARLOS III MADRID, Economic Series Working Paper No. 12-33, Dec. 2012).

⁷² See Christopher Drahozal, "Unfair" Arbitration Clauses, 2001 U. ILL. L. REV 695 (2001), discussing *Stiles v. Home Cable Concepts, Inc.*, 994 F. Supp. 1401 (M.D. Ala. 2004).

less than \$1,000 per claimant, it fails to note that class actions against financial services providers also seem to seldom involve claims of less than \$1,000 per claimant. The CFPB is to be lauded for looking at a large number of actual case files for data on class action outcomes and settlements. However, its summary data on the fraction of class members who receive compensation (claims rates) and on attorney's fees as a fraction of class recovery are aggregated averages that conceal substantial variation across case types in both claims rates and the relative size of attorneys' fee awards—variation that includes many class settlements with very low claims rates and attorneys' fees that are very large compared to the aggregate payout to the class. Finally, in several respects—as by presenting data on arbitration awards but none on arbitration settlements, while presenting data only on class action settlements—the CFPB invites misleading comparisons that tend to bias rather than illuminate the public policy debate.

A. The Paucity of Small-Dollar Arbitrations

Perhaps the most emphasized finding in the CFPB's preliminary results is the discovery that “almost no AAA arbitration filings for these three product markets had under \$1,000 at issue.”⁷³ More precisely, the preliminary results report states,

[D]uring the period 2010 through 2012, there were an annual average of seven arbitrations per year filed with the AAA that concerned disputed debt amounts that were at or below \$1,000, and . . . an annual average of under eight AAA arbitrations in which there was no disputed debt amount identified and the affirmative claim amount was at or below \$1,000.⁷⁴

The preliminary results report later states that only 23 consumer claims were for less than \$1,000, with some 14 being for exactly \$1,000.⁷⁵

⁷³ CFPB (2013), *supra* note 8, at 14.

⁷⁴ *Id.*

⁷⁵ *Id.* at 81.

In the particular arbitration type that the CFPB calls *debt disputes*,⁷⁶ the agency invokes both the Chamber of Commerce and Justice Stephen Breyer to define a *small-dollar claim* as one in which the consumer claims no more than \$1,224.⁷⁷ For such claims, the CFPB reports that “there were under 19 cases on average each year in which there was a ‘small dollar’ debt dispute. Looking only at cases without disputed debt amounts, but only affirmative claim amounts, there were just over 8 cases each year on average that were ‘small dollar.’”⁷⁸

Noting the relatively small number of arbitration claims of under \$1,000, the CFPB implies that the absence of these small-dollar claims from the dataset suggests that arbitration is not a feasible dispute resolution procedure for many consumers. Moreover, in the preliminary results, the CFPB compares the relative absence of small-dollar claims by consumers in arbitration unfavorably with certain class action cases in which the constituent consumers have recovered positive albeit modest amounts. This comparison might suggest that class actions are a more feasible means for aggregating smaller claims than is requiring disputes to be resolved by individual arbitration. The next section of this paper will examine the claims regarding the comparative efficiency of arbitration versus class litigation; this section will discuss briefly why the apparent absence of small-dollar claims from the CFPB’s data cannot necessarily be read to suggest that arbitration is not a feasible means for consumers to recover monetary amounts in small-dollar disputes.

⁷⁶ The following numbers refer to the 326 cases for which the CFPB could identify a claim form amount but could not identify a disputed debt amount. Of those cases, 146 involved credit cards, with a median claim of \$8,945; 61 involved checking accounts, with a median claim of \$15,000; and 119 involved payday loans, with a median claim of \$42,500. *Id.* at 80.

⁷⁷ Here is how the CFPB gets the \$1,224 threshold for a “small-dollar claim”: First, it uses Justice Breyer’s example, from *Allied-Bruce Terminix Cos. v. Dobson*, 513 U.S. 265, 281 (1995) of a small-dollar claim being one that involves the “value of only a refrigerator or television set.” *Id.* at 82. Then the CFPB uses *Time* magazine’s report that the average price of a new TV in the second quarter of 2012 was \$1,224.

⁷⁸ *Id.* at 82.

One obvious possible explanation for the relative absence of small-dollar disputes in arbitration procedures is that many disputes are resolved without arbitration *or* litigation. In particular, as we have explained, financial institutions routinely provide refunds and other adjustments to fees and the like in an effort to preserve customer goodwill and relationships. The example of bank refund practices discussed previously suggests that one plausible explanation for a relative paucity of small-dollar arbitration disputes is that many complaints (especially valid complaints) that might otherwise lead to arbitration or litigation are instead resolved internally with relief to the consumer. Indeed, if refunds are more likely to be granted for meritorious complaints than for frivolous complaints, then the overwhelming number of meritorious complaints may be resolved consensually rather than by conflict. Perhaps one reason that those denied a refund do not arbitrate is that their complaints lack merit.⁷⁹

The likelihood that many financial institutions internally refund or adjust many charges incurred by consumers indicates that the CFPB cannot assume that arbitration is not a viable resolution system because of the relative paucity of small-dollar disputes found in the dataset. In fact, at the one bank for which we have data, consumers prevailed 68% of the time in obtaining refunds.⁸⁰ To suggest otherwise would perversely imply that, rather than handling disputes internally and issuing refunds, financial institutions should force consumers to arbitrate. More important, several alternative explanations can account for the apparent paucity of small-dollar arbitrations involving financial institutions; before the CFPB can assume that the apparent lack of such cases means that arbitration is not financially feasible, it must first consider those other explanations.

⁷⁹ Indeed, given the value of goodwill with consumers and the relative cost of the dispute process to the amount typically at stake, the bank seems likely to err on the side of being overly generous in granting refunds in many cases.

⁸⁰ We are unaware of any comparable data from any other bank, but we have no reason to believe that the internal dispute resolution and account adjustment patterns of this particular bank are particularly unique or unrepresentative.

B. The Selective Class Action Data in the Preliminary Results

Perhaps the most striking rhetorical feature of the CFPB's preliminary results was that immediately after highlighting that there were only 23 AAA consumer arbitrations over the period 2010–2012 involving what it called “small-dollar claims,” the CFPB report went on to “compare the benefits to consumers from arbitration to the benefits from class action litigation.”⁸¹ This exercise, however, involved comparing all consumer arbitrations before the AAA over the period 2010–2012 to a very small sample of settlements in consumer class actions. The CFPB discussed only eight such settlements because, for unexplained reasons, it studied only settlements reached after the latter half of 2009 in cases involving a contract between consumers and providers that dealt with one the agency's three product areas and that contained an arbitration clause. The eight settlements were found by looking at “electronic databases, as well as blogs and websites that track class action settlements.”⁸² Of the eight settlements described by the CFPB, three cases alleged violations of state payday loan laws, three involved allegedly fraudulent checking account overdraft fees, one was a credit card case, and one involved currency. In all the settlements described by the CFPB, a large number of members of the class actually received small payouts:

- Of the 10 million consumers who submitted claims in *In re Currency Conversion Fee Antitrust Litigation*, 7 million received a flat fee of \$17 while the other 3 million “submitted more detailed claim materials, which entitled them to a significantly larger recovery.”⁸³

⁸¹ CFPB (2013), *supra* note 8, at 102.

⁸² *Id.* at 103.

⁸³ *Id.* at 105.

- *Hoffman v. Citibank*, a case challenging Citibank's actions in retroactively increasing the interest rates on some customers' outstanding credit card balances in alleged violation of California laws, resulted in interim payments of \$18 each to 12,500 claimants.⁸⁴
- In *Hooper v. Advance America*, a payday loan case alleging violations of Missouri's payday loan statute and Merchandising Practices Act, 10,400 consumers submitted claims and shared \$520,000 in cash payments and \$9 million in debt forgiveness.⁸⁵
- In *Kucan v. Advance America*, another payday loan case alleging violations of North Carolina's payday lending statute, 135,000 members shared via automatic payments in a settlement fund of \$11.5 million, or about \$85 per class member.⁸⁶
- In a third payday loan case, *Hager v. Check into Cash*, which also alleged violations of North Carolina's payday lender statute, automatic payments totaling \$7.6 million were made to 104,000 class members, or \$73 per class member.⁸⁷
- *In re Checking Account Overdraft Litigation*, a multidistrict action in which class actions from across the country were consolidated in the Southern District of Florida, alleged that the banks processed debit transactions in such a way as to create overdrafts and thus generate overdraft fees. The bank defendants and the settlements identified by the CFPB were (a) Chase, which settled in 2012 with 5 million class members, who each received \$61 and agreed to restrictions on fees for transactions under \$5 (the court valued this additional relief at \$52 million); (b) M&I, which paid \$2.7 million, or \$14 each, to 190,000 class members with no claim form required; and (c) Compass Bank,

⁸⁴ *Id.* at 106.

⁸⁵ *Id.*

⁸⁶ *Id.* at 107.

⁸⁷ *Id.* at 107–8.

which sent a notice to 826,000 class members that they shared \$8 million in case relief, or \$9 each.⁸⁸

It is noteworthy that the CFPB preliminary results identified per claimant payouts only for the larger payouts, such as Chase (we computed the per claimant payout for M&I and Compass). Also, in describing all the class action settlements, the CFPB takes great pains to count the number of consumers who opted out of each settlement and then pressed the same claim against the same defendant in arbitration. The CFPB then stresses that there were “three arbitrations in which an opt-out from one of these cases *may* have made the same claim in AAA arbitration against a party within the scope of the applicable settlement.”⁸⁹ It continues,

No other opt-out from one of these cases appears to have filed the same dispute before the AAA. A total of 3,605 individuals opted out of these settlements. More than 13 million class members made claims or received payments under these settlements. Total payments or debt relief to the classes are in excess of \$350 million, exclusive of attorneys fees and the value of injunctive relief.⁹⁰

C. The More General Class Action Filing and Settlement Data in the Final Report

An obvious problem with the presentation of this class action settlement data in the 2013 preliminary results is that only eight large and potentially unrepresentative class action settlements are discussed. In the 2015 Report, the CFPB attempted to remedy the lack of representation by gathering data on a much larger set of class actions. The CFPB reported on all federal court class action filings and on filings in selected state courts that involved six types of financial products: credit cards, checking and debit accounts, payday loans, prepaid cards, private student loans, and automobile loans. For these six products over the period 2010–2012,

⁸⁸ *Id.* at 109.

⁸⁹ *Id.* at 104.

⁹⁰ *Id.*

the CFPB found 470 federal court filings and 92 state court filings.⁹¹ Quite differently, the CFPB also reported on all class action settlements in federal court over a period twice as long—covering 2008–2012—involving five of these products (automobile loans, student loans, credit cards, checking and savings accounts, and prepaid cards) plus settlements involving credit reporting, debt collection, debt settlement, mortgages, and privacy.⁹²

From these data, the CFPB reported three important statistics about class actions. First, it reported aggregated data showing that for the class action settlements it found over the 2008–2012 period, more than 11 million consumer class members received \$1.1 billion in compensation.⁹³ By comparison, the CFPB reported that for arbitrations it studied over the period 2011–2012, it could verify arbitral awards to only 32 consumers (or 20% of consumers making affirmative claims for relief) for a total of \$172,433.⁹⁴ Second, for the 105 class action settlements for which the CFPB was able to calculate a rate at which consumer class members actually received compensation, it found that the unweighted average claims rate was 21%, with an average weighted claims rate of 11%.⁹⁵ Third, the CFPB reported that attorneys' fees averaged 21% of the cash relief (and 16% of the total relief, including in-kind) received by class members.⁹⁶ Because the final two findings—on the fraction of class members receiving compensation and attorneys' fees as a fraction of what class members receive—are strikingly at odds with what has previously been reported, we begin by discussing those.

1. The CFPB's class action claims rate data presents a misleading picture of claims rates in class action settlements and obscures evidence that for many and perhaps most class actions,

⁹¹ CFPB (2015), *supra* note 9, section 6, at 17.

⁹² *Id.*, section 8, at 12.

⁹³ *Id.*, section 8, at 27–28.

⁹⁴ *Id.*, section 5, at 41.

⁹⁵ *Id.*, section 8, at 30.

⁹⁶ *Id.*, section 8, at 33.

fewer than 10% of the class actually receive compensation. The CFPB reports that on (unweighted) average 21% of consumer class members received some kind of compensation under class settlements. This report paints a relatively rosy picture of class action settlements. When it comes to consumer compensation under class action settlements, previous research has found wide variation in the fraction of the class that actually receives compensation (the payout or claims rate), with claims rates often below 5% in large class actions where consumers have to fill out forms to receive compensation.⁹⁷ As the CFPB Report correctly points out, the defect in this research is that it does not work from case files themselves.⁹⁸ Instead, previous researchers have looked for reports of class action settlements in places such as the *BNA Class Action Reporter*⁹⁹ or, at best, have studied actual settlements but only in a very small number of class actions.¹⁰⁰

In the Report, the CFPB got information about class action settlements from the docket sheet case records and through selective interviews with settlement administration companies (the organizations that actually manage the process of notifying and paying class members). Because every class action settlement requires the court to make a fairness determination, the federal court PACER (Public Access to Court Electronic Records) docket sheet data typically includes several documents from which one can discern a good deal about class action settlement

⁹⁷ See, for example, DEBORAH HENSLER ET AL., CLASS ACTION DILEMMAS: PURSUING PUBLIC GOALS FOR PRIVATE GAINS (Rand, 2000); NICHOLAS PACE ET AL., INSURANCE CLASS ACTIONS IN THE UNITED STATES (Rand, 2007); MAYER BROWN LLP, DO CLASS ACTIONS BENEFIT CLASS MEMBERS? AN EMPIRICAL ANALYSIS OF CLASS ACTIONS (2013).

⁹⁸ CFPB (2015), *supra* note 9, section 8, at 6–7, 29–30.

⁹⁹ For an example of a study that looks to such reporters for data on class action settlements, see Mayer Brown LLP, *supra* note 97.

¹⁰⁰ Brian T. Fitzpatrick & Robert C. Gilbert, *An Empirical Look at Compensation in Consumer Class Actions*, (VAND. U. L. SCHOOL, Law and Economic Working Paper No. 15-6, March 2015). The paper looks at actual settlement terms for 15 consumer class actions, but 13 of them come from the consolidated *In Re Checking Account Overdraft Litigation*, the CFPB's major case study, which as we discuss *infra* is highly unrepresentative of the typical consumer class action settlement.

terms. For its 2015 Report, the CFPB looked at the largest sample of class action settlements ever studied, all settlements for selected types of class actions over the 2008–2012 period.

a. The CFPB failed to consistently adhere to its own stated methodology for determining what sorts of class action settlements to include in its study sample. There are several problems with the CFPB’s reported numbers on class action claims rates. First, the CFPB did not consistently apply its own stated criterion for determining what kinds of class action settlements it would include in its sample. The CFPB stated that it did not study consumer class actions involving what was obviously a financial service—class actions alleging that ATM machines did not have a notice of fees “on or at” the machine, as the Electronic Funds Transfer Act (EFTA) then required—because ATM plaintiffs might not be customers of the ATM provider and therefore potentially would not be covered by the defendant’s arbitration clause.¹⁰¹

If the CFPB had applied the same rationale that it applied to exclude ATM notice failure cases, then it would have excluded many and perhaps most of the class settlements in its study. According to the CFPB, 55% of the class action settlements it studied involved debt collection.¹⁰² Debt collection class actions in federal court are typically brought under the Fair Debt Collection Practices Act (FDCPA) or the Telephone Consumer Protection Act (TCPA). The FDCPA protects consumers against a variety of harassing debt collection practices and also requires debt collectors to make certain disclosures, whereas the TCPA protects consumers against autodialed phone calls and text messages (typically made for debt collection or mass marketing and advertising). Both statutes apply to debt collection actions taken by the creditor (e.g., a subprime auto lender) or a debt collection company hired by the creditor (e.g., a law firm

¹⁰¹ CFPB (2015), *supra* note 9, appendix L, at 74.

¹⁰² *Id.*, section 8, table 8, at 25.

doing debt collection). Debt collection companies are not in a contractual relationship with consumers; they are independent contractors hired by debt holders to collect debts. Hence, the majority of the courts that have decided the issue have said that such independent contractors are not parties to the contract between the consumer and the original creditor and, therefore, may not avail themselves of any mandatory arbitration provision in that contract.¹⁰³ Thus, because many of its debt collection settlements likely involved claims against debt collection companies, the CFPB should have excluded many and perhaps most of the settlements in its sample according to its own stated criterion for sample construction.

b. The CFPB's aggregate average class claims rate obscures evidence of enormous variation in claims rates across different case types. The CFPB might well counter by arguing that because most debt collection class settlements are quite small,¹⁰⁴ both in terms of the size of the class and the size of the aggregate payout to the class, its inclusion of so many debt collection settlements is unlikely to have had a major effect on its reported claims rate. The kind of claims rate reported by the CFPB, however, is likely to obscure what the bulk of class action settlements actually bring for class members.

The reason for this lack of clarity is that the CFPB's reported claims rate is an aggregate average. The CFPB's claims rate is equal to its estimate of the total number of class members receiving payments in its sample divided by its estimate of the total number of class members in that same sample.¹⁰⁵ Thus, the CFPB's claims rate lumps all types of class action settlements together, simply reporting an aggregated average claims rate.

¹⁰³ Richard M. Alderman, *The Fair Debt Collection Practices Act Meets Arbitration: Non-parties and Arbitration*, 24 LOY. CONSUMER L. REV. 586 (2012).

¹⁰⁴ From CFPB (2015), *supra* note 9, section 8, table 8, at 25, one can see that the total relief in debt collection settlements was only about 4% of the total cash relief across all product categories.

¹⁰⁵ *Id.*, section 8, at 26–27.

The Report shows that the total or aggregate cash payouts to class members for checking account and credit card class actions is about \$1.4 billion.¹⁰⁶ This amount is 67% of the total cash relief in all class settlements studied by the CFPB, even though these cases make up a small portion of the total number of class settlements. Some of these cases are among the class settlements that the CFPB covered in its selective report on class action settlements in its 2013 preliminary results. Referring to the preliminary results, one sees that in the checking account overdraft litigation (consolidated in the Southern District of Florida) alone, the settlements discussed by the CFPB compensated about 6 million class members.¹⁰⁷ Thus, a very small number of large cases involving huge plaintiff classes are driving the results, even though those cases are likely not typical of most class action cases.

2. The CFPB's Report on attorneys' fees relative to class payouts is also an aggregate average that conceals variation across case types and enormously high attorneys' fees relative to the class payout for some types of consumer class actions. The CFPB reports that attorneys' fees in class settlements are a surprisingly low 21% of the total cash compensation paid to class members (and an even lower 16% of what it calls "total gross relief"). But the CFPB's number for attorneys' fees as a fraction of class payout is generated by the same sort of aggregate average method used to compute class payout rates. The CFPB divided total attorneys' fees paid in all its class settlements by the total amount paid to class members in those settlements.¹⁰⁸ However, the CFPB did apply this method for each case type, so that one may see the fraction of total attorneys' fees paid relative to the total cash relief in class settlements in, for example, settlements that the CFPB categorized as involving credit cards or checking accounts. The CFPB

¹⁰⁶ *Id.*, section 8, table 8, at 25.

¹⁰⁷ CFPB (2013), *supra* note 8, at 105–8.

¹⁰⁸ CFPB(2015), *supra* note 9, section 8, at 33.

also broke down attorneys' fees relative to the amount paid to the class for different categories of total class payments. These data reveal that although attorneys' fees are a relatively small percentage of class payments for the largest class settlements (averaging only 9% for settlements larger than \$100 million), they constitute a much higher fraction of the class award for smaller total class payments (averaging 57% for class awards less than or equal to \$100,000).¹⁰⁹

After reporting these relatively disaggregated numbers on attorneys' fees as fraction of class payouts, the CFPB states that "[o]ver 90% of individual class members in consumer financial settlements . . . are in settlements where the fee rate is under 40% . . . [and] the vast majority of class members are in settlements where the fee rates, . . . are less than 20%."¹¹⁰ Similarly, the CFPB defends its method of presenting a ratio of attorneys' fees to class payouts by aggregating payouts and fees across all cases within a given category (either financial product category or payout amount) as an approach that reflects the fact that attorneys' fees tend to be a lower fraction of the class payout when payouts are bigger.¹¹¹

An obvious consequence of this approach is that the CFPB's reported number for attorneys' fees as fraction of total class payout for both all settlements and any given type of settlement (e.g., credit card or checking account) will reflect the relatively low attorneys' fees in settlements with the biggest class payouts. Thus, it is possible—and perhaps likely—that attorneys' fees for most cases (both overall and for a particular case type) are much higher than the number reported by the CFPB, *even exceeding the class recovery*, but this problem would be completely hidden by the CFPB's methodology.

¹⁰⁹ *Id.*, section 8, tables 10 and 11, at 33–34.

¹¹⁰ *Id.*, section 8, at 34.

¹¹¹ *Id.*, section 8, at 33–34.

3. *The CFPB's aggregative data on class settlements does not really illuminate the choice between arbitration and class actions.* Perhaps the biggest problem with the aggregate averages that the CFPB reports for both class action claims rates and attorneys' fees as a fraction of total class payout is that such averages are swamped by numbers from settlements in a mere *six* class actions that account for only 2% of the CFPB's class action settlements with cash payouts. The total cash payout to class members of about \$812 million in these six settlements makes up 83% of total cash payouts in the 241 settlements studied by the CFPB.¹¹² Although the CFPB does not report the number of class members paid in these six monster class actions, it seems clear that that the classes were huge. When the CFPB reports that attorneys' fees are relatively low and class claims (payout) rates relatively high, it is really saying that for these six settlements attorneys fees are relatively low and payout rates are relatively high.

This information could have some relevance to the design of public policy regarding arbitration as a substitute for class actions. But that relevance is likely less than it might first appear. Such information might seem to be directly applicable, thereby implying that class actions are a cost-effective method of consumer compensation and deterrence in cases with enormous numbers of consumers and aggregate damages but small harm to the consumers individually. But this reasoning presumes that the defendant's conduct underlying the biggest class action settlements was actually wrongful. Because such settlements do not involve an adjudication of wrongfulness—and, indeed, are virtually always justified by class counsel on the ground that they might not succeed on the merits—they may arise in cases where there is no actual wrong to be compensated or deterred but massive discovery costs to be avoided. Hence, even when the settlements reported by the CFPB have seemingly good outcomes, it is not clear

¹¹² *Id.*, section 8, at 28–29.

that those settlements were socially desirable. The CFPB's data on class settlements, though somewhat informative, do not shed light on the crucial questions that must be answered to make a relative evaluation of class actions and arbitration.

D. The Misleading Comparison of Class Action Settlement Payouts to Arbitral Awards

Indeed, read as a whole, the CFPB's study does more to mislead the comparison of arbitration and class actions than it does to inform and guide that comparison. Recall that the CFPB reported aggregated data showing that, for the class action settlements it found over the 2008–2012 period, more than 11 million consumer class member received \$1.1 billion in compensation,¹¹³ whereas for arbitrations it studied over the period 2011–2012, it could verify arbitral awards to only 32 consumers (or 20% of consumers making affirmative claims for relief) for a total of \$172,433.¹¹⁴ This comparison of aggregate payouts from class actions and arbitration surely could be taken to show that arbitration is the weaker instrument of compensation. The CFPB's presentation, however, is a misleading conflation of two different types of data.

In presenting data on arbitral awards for consumers, the CFPB is careful to note that, in the 20% of AAA arbitrations over the 2011–2012 period in which consumers making affirmative claims received such an award (32 of 158 such claims), they received on average only 57% of what they claimed (or as the CFPB puts it, an average of 57 cents for every dollar that they claimed).¹¹⁵ Although the CFPB reports on aggregate class action settlement amounts (and amounts per class member) for different types of class actions, nowhere does the CFPB Report present comparable information on how the actual settlement payout to individual class members compares with the per plaintiff damages claimed.

¹¹³ *Id.*, section 8, at 3–5.

¹¹⁴ *Id.*, section 5, at 41.

¹¹⁵ *Id.*

This does not mean that class settlements for less than statutory damages are somehow suspect. To the contrary, basic economic theory predicts that settlement amounts will typically be less than the maximum amount recoverable in litigation. The same dynamic may be at work in arbitration, but the CFPB presents no data on AAA consumer arbitration settlements because it did not have access to such data. Still, the CFPB did present data showing that 23% of AAA consumer arbitrations were known to have settled, with another 34% likely to have settled.¹¹⁶ Thus 57%, or the vast majority of AAA consumer arbitrations studied by the CFPB, were likely or known to have settled. Without data on the settlement amounts in those cases, it is highly misleading for the CFPB to present data on consumer arbitral awards. Had the CFPB made a proper apples-to-apples data comparison, it would have compared consumer recovery in successful consumer arbitrations not to class action settlements but to the 2% of consumer class actions in which consumers got an individual or classwide judgment.¹¹⁷ Instead, the numbers that the CFPB does report invite a misleading comparison of class settlements to arbitral awards.

E. Claims Less Than \$1,000 against Financial Products and Services Providers Are Relatively Rare—Regardless of Whether They Are Arbitrated or Litigated

In its preliminary results study, the CFPB reported finding “almost no” AAA arbitration filings in the three product markets it studied that involved claims of less than \$1,000. Although the CFPB did not give numbers for the fractions of claims falling within different ranges, it did present figure 14, reprinted here as figure 1,¹¹⁸ which shows the overall distribution of claims. The figure does not indicate that the actual number of claims less than \$1,000 found by the

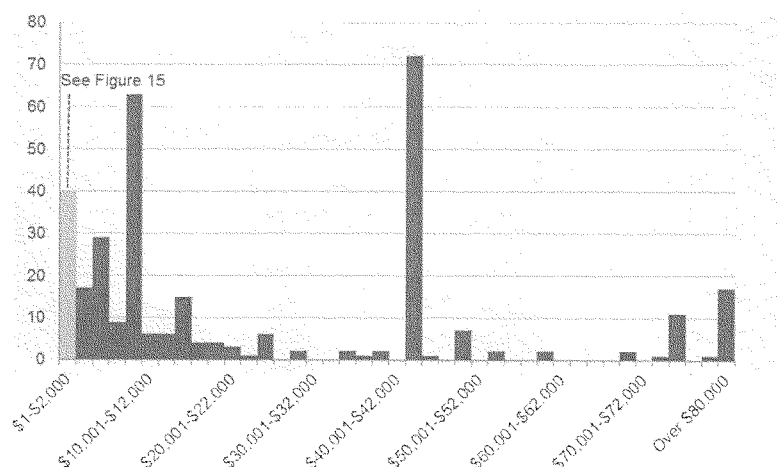
¹¹⁶ *Id.*, section 5, at 33.

¹¹⁷ *Id.*, section 6, at 39.

¹¹⁸ CFPB (2013), *supra* note 8, at 81.

CFPB, 23, is especially unusual; indeed, very small claims appear to be more likely than, say, claims in the \$50,000–\$70,000 range.

Figure 1. Distribution of Claim Amounts in AAA Arbitrations Studied in the Consumer Financial Protection Bureau Preliminary Results

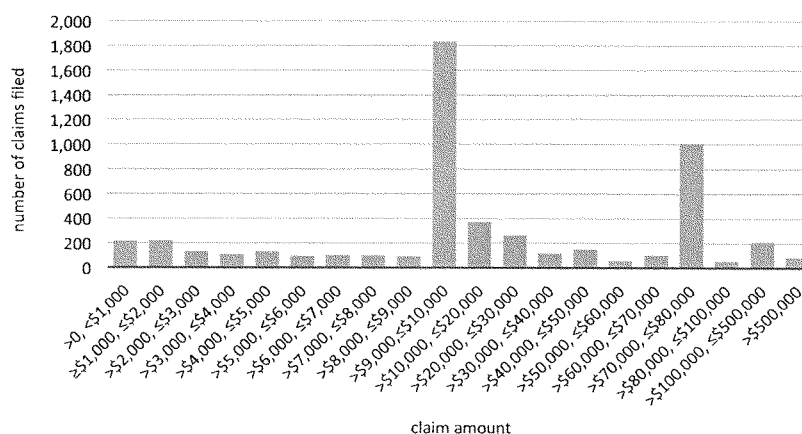


Source: Consumer Financial Protection Bureau, *Arbitration Study: Preliminary Report*, 81, figure 14 (2013). “See Figure 15” in the chart refers to a figure in the source publication.

Still, clearly CFPB’s sample did not include a large number of arbitrations with claim amounts less than \$1,000. But it would be wrong to infer from this finding—restricted as it is to arbitrations involving particular product markets—that consumer arbitrations for less than \$1,000 are rare among all AAA consumer arbitrations. Figure 2 shows the distribution of claim amounts (in filings with nonzero claims) for all AAA consumer arbitrations filed over the period 2009–2014, the most recent period for which publicly available AAA data exist online. A quick glance at figure 2 indicates that in this dataset, too, few claims for less than \$1,000 were filed. But in fact, the 219 claims that were less than \$1,000 make up 3.5% of all claims, and claims less

than or equal to \$2,000 make up 7% of all claims. By comparison, in the CFPB's AAA financial products arbitrations, claims for less than \$1,000 make up only 2% of all claims.¹¹⁹ In other words, small claims were 75% more likely in the overall AAA consumer filing dataset than in the CFPB's financial products AAA consumer dataset. The fact that a nontrivial number of small-dollar AAA arbitrations are brought for other products, suggests that small-dollar arbitrations actually are feasible. In turn, the finding suggests that the relative scarcity of small-dollar consumer arbitrations against financial institutions may reflect something other than the economic feasibility of arbitrations and some factor unique to financial services, such as more robust internal dispute resolution practices.

Figure 2. Frequency of Claim Amounts, All AAA Consumer Arbitrations, 2009–2014



Source: Data compiled from AAA consumer arbitration statistics, available at https://www.adr.org/aaa/faces/aoc/gc/consumer/consumerarbstat?_afLoop=209719868901203&_afWindowMode=0&_afWindowId=8ok8435fw_1#%40%3F_afWindowId%3D8ok8435fw_1%26_afLoop%3D209719868901203%26_afWindowMode%3D0%26_adf.ctrl-state%3D8ok8435fw_51.

¹¹⁹ This number results from dividing the 23 small arbitrations that the CFPB identified by 1,060, the total number of arbitrations in its sample.

The evidence about both class actions and arbitrations suggests that further work is needed to investigate precisely why one sees a relatively low number of small-dollar claims both in consumer class actions and consumer arbitrations. Such work should recognize, however, that the \$1,000 threshold appears to be a poor indicator of whether a claim against a financial products provider is a “small-dollar” claim. One reason that \$1,000 is a poor way to define small claims against financial products and services providers is that many (and probably most) class actions against financial product suppliers are brought under federal consumer protection statutes that authorize statutory damages up to either \$1,000 or \$1,500 per claimant without proof of injury. Therefore, those amounts are the effective minimum amounts claimed by a class member in such class actions, regardless of how small the actual individual harm may be.

One of the new pieces of information provided by CFPB concerns the substantive legal basis for AAA consumer arbitrations. The CFPB found that virtually all the arbitrations it studied involve a federal or state statutory claim or both. For example, the preliminary results indicate that for noncollection credit card arbitrations, federal statutory claims make up 59% and state statutory claims another 21%.¹²⁰ The federal and state consumer protection statutes that consumers invoke in AAA arbitration are essentially the same (although appearing in different proportions) as those that provide the basis for consumer class actions against financial product providers.¹²¹

Because AAA consumer financial products arbitrations proceed under the same kinds of federal (and state) consumer protection statutes as do consumer class actions involving these products, it would be surprising to find that many AAA consumer arbitrations claimed less

¹²⁰ CFPB (2013), *supra* note 8, at 86–87.

¹²¹ The CFPB preliminary results find that in the credit card arbitrations, 39% of claims rely on the Fair Debt Collection Practices Act, 22% on the Fair Credit Reporting Act, and 16% on the Fair Credit Billing Act. *Id.* at 86.

than \$1,000 (or sometimes \$1,500). The CFPB's study, referring as it does to a 1995 opinion by Justice Breyer as its benchmark for a small-dollar consumer claim, seems to ignore the fact that virtually all consumer claims are brought under federal or state consumer protection statutes that entitle consumers to at least \$1,000. In such cases, Breyer's \$1,000 figure is no longer a useful threshold.

VII. What CFPB Should Do before It Considers Prohibiting Arbitration

The CFPB's Report provides some useful new information about both consumer class actions and arbitrations involving selected financial products and services, but it does not provide data on key measures of the performance of either class actions or arbitrations. Most notably, the Report contains no information on the size of arbitral settlements, and it does not provide data on class action settlements that are sufficiently fine-grained to allow one to see how class payout rates and attorneys' fees vary with case type. Some of the CFPB's findings actually undermine several key arguments that are often asserted to justify restrictions on arbitration, such as the supposed unfairness of arbitration procedures. The Report shows not only that most AAA consumer claimants have counsel but also that they usually do not need it: the CFPB's Report provides evidence that AAA arbitration may be the only way for consumers to successfully seek outside redress without resort to hiring costly legal counsel.

Although the relative absence of small-dollar disputes between consumers and financial institutions in the AAA data might suggest that arbitration is ineffective for dealing with such disputes, the absence of such observations alone cannot sustain the conclusion that the disputes are not economically feasible to arbitrate. First, in an era when virtually all consumer legal actions—whether adjudicated before the AAA or in federal court—are brought under federal consumer protection statutes authorizing statutory damages (often without proof of injury to the

consumer), it is difficult even to identify what constitutes such a claim. Second and more importantly, the CFPB's Report provides no evidence for why disputes involving very small claim amounts are not typically arbitrated. However, as we noted, data provided by one financial institution indicates that it grants refunds to 68% of customers who complain, suggesting that the bank has a well-established internal system for resolving meritorious small-dollar consumer claims, premitting either arbitration or litigation. Together with the CFPB's survey evidence showing that consumers do, indeed, punish firms that try to attach unreasonable charges and fees by taking their business elsewhere, it may well be that truly small-dollar claims are increasingly being eliminated by the market itself.

Public policy in the United States has long supported the use of arbitration and other means of dispute resolution as an alternative to litigation. Indeed, in at least some areas (such as securities litigation), Congress has acted in recent years to pare back the scope of class action lawsuits. It is generally recognized that reckless and irresponsible class action cases can be harmful to consumers, businesses, and the economy as a whole. Frivolous class action cases impose both direct and indirect costs on businesses that inevitably are passed on to consumers in the form of higher prices, reduced quality, or reduced innovation and consumer choice. In the context of consumer financial products, such lawsuits drive up the cost of doing business, and those costs are passed on to consumers in the form of higher interest rates and restricted credit availability. In perhaps its most glaring omission, however, the CFPB Report makes no attempt to assess the merit of consumer class actions that end in the class action settlements it reports. It does not present any data that even illuminate which firms tend to settle and which do not and how key measures of class action performance (claims rates and attorneys' fees relative to the class payout) vary with the statutory basis of the claim settled. After reading the voluminous Report, one knows

no more about whether the settlement of frivolous consumer class actions is a real social problem than one did before reading it. Likewise, one knows no more about whether arbitration realizes its promise of achieving more accurate determination of consumer disputes on the legal merits.

Although the point is largely ignored in the Report, over time courts have developed a robust and evolving jurisprudence to protect consumers in cases involving unfair arbitration clauses.¹²² The CFPB's Report does not provide anywhere near the kind of information that would be necessary for the CFPB to craft *ex ante* regulation of consumer arbitration clauses that would do a better job of weeding out unfair arbitration clauses than what courts have done through *ex post* adjudication. Indeed, broad regulatory action by the CFPB that might nullify or discourage consumer arbitration could preempt what has become quite precise judicial supervision and fine-tuning of consumer arbitration clauses. Such *ex post* judicial supervision seems already to have changed that way that companies such as AT&T draft arbitration clauses, leading to arbitration procedures that are cheap and easy for consumers to pursue and that offer consumers large payments (in AT&T's case, \$10,000) when the consumer wins. Consumer arbitration is only in its infancy. It has tremendous promise. The CFPB's Report provides no evidence for this promise to be aborted by expansive new CFPB regulation.

¹²² And as argued by Drahozal, *supra* note 72, judicial policing is not the only mechanism for ensuring substantively fair terms in mandatory arbitration clauses. Firm reputation and other market sanctions also play a role.



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May 17, 2016

The Honorable Randy Neugebauer
Chairman
House Financial Services Committee
Subcommittee on Financial Institutions &
Consumer Credit
United States House of Representatives
Washington, D.C. 20515

The Honorable William Lacy Clay
Ranking Member
House Financial Services Committee
Subcommittee on Financial Institutions &
Consumer Credit
United States House of Representatives
Washington, D.C. 20515

Re: Tomorrow's Hearing on the CFPB's proposed rulemaking on Arbitration

Dear Chairman Neugebauer and Ranking Member Clay:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association exclusively representing the federal interests of our nations federally-insured credit unions, I write today in conjunction with tomorrow's hearing, "Examining the CFPB's Proposed Rulemaking on Arbitration: Is it in the Public Interest and for the Protection of Consumers?" NAFCU and our members are reviewing the CFPB's arbitration proposal for its impact on credit unions and their nearly 103 million member-owners.

NAFCU believes that consumers should have access to fair and efficient methods of dispute resolution. Credit unions have a solid reputation of working with their members to resolve disputes when they arise. Many credit unions have found that voluntary arbitration agreements are often the most optimal solution for resolving disputes, both in terms of efficiency for the credit union, and fairness for the member. To that end, we would hope that the CFPB would avoid promulgating any final rule that unreasonably limits the availability of arbitration as a tool or creates burdensome reporting requirements that can negatively affect credit unions. NAFCU is especially concerned with the proposal to collect and publish arbitration data, as such actions would create system-wide reputational risk, raise privacy concerns and encourage frivolous lawsuits.

We are continuing to examine the proposal and will be sharing our comments with the CFPB through the appropriate channels in the comment process. We thank you for holding this hearing and look forward to continuing to work with the subcommittee on this and other issues of importance to credit unions. If NAFCU can be of assistance to you, or if you have any questions regarding this issue, please feel free to contact me, or NAFCU's Senior Associate Director of Legislative Affairs, Chad Adams, at 703-842-2265.

Sincerely,

Brad Thaler
Vice President of Legislative Affairs

cc: Members of the House Financial Services Subcommittee on Financial Institutions and
Consumer Credit



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May 17, 2016

The Honorable Randy Neugebauer
Chairman
Financial Institutions and Consumer Credit
Subcommittee
Committee on Financial Services
House of Representatives
Washington, DC 20515

The Honorable William Lacy Clay
Ranking Member
Financial Institutions and Consumer Credit
Subcommittee
Committee on Financial Services
House of Representatives
Washington, DC 20515

Dear Chairman Neugebauer and Ranking Member Clay:

On behalf of America's credit unions, I am writing regarding tomorrow's hearing entitled, "Examining the CFPB's Proposed Rulemaking on Arbitration: Is it in the Public Interest and for the Protection of Consumers?" The Credit Union National Association (CUNA) represents America's credit unions and their more than 100 million members.

CUNA shares the Subcommittee's concerns about whether this rule is in the best interest of consumers. As the only consumer-owned cooperatives in the financial marketplace, credit unions have a tradition of protecting their members' interests, and in most instances are able to amicably resolve any disputes that arise. Nevertheless, arbitration can be a helpful alternative for credit unions and their members to resolve differences in a fair, efficient, timely, and cost-effective manner.

Credit Unions Dispute Resolution Process is Different than Other Financial Institutions

The Consumer Financial Protection Bureau's (CFPB) arbitration proposal, while not an explicit ban, is a *de facto* ban on the effectiveness of the arbitration process. By removing a tool from the dispute resolution toolbox, it tells credit union members to bypass an efficient and cost-effective resolution process and head straight to the courthouse.

This is troublesome for credit unions, in particular, for at least two reasons. First, it is hard to imagine a case in which class action litigation against a credit union would be a reasonable course of action for credit union members since it would put them in a position of essentially having to sue themselves, as they are member-owners of the credit union. Second, in the rare situation that a group of credit union members feels a credit union is in the wrong, the group, as member-owners, already have direct recourse to remove the credit union's Board of Directors and management using their one-member, one-vote membership powers.

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Straining Credit Union Resources Does Not Benefit Consumers

The arbitration proposal comes in the wake of several recent regulatory changes by the CFPB and other regulators that have made financial institutions more vulnerable to frivolous class-action lawsuits. Eliminating an option while providing no alternative solutions other than to rely on the attorney fee-driven plaintiffs' bar is no solution at all. As an example, onerous regulations concerning the Telephone Consumer Protection Act from the Federal Communications Commission have increased chances that credit unions could be sued for a minor technical violation when trying to communicate with their members using an autodialer. This particular law has no cap on statutory damages. Accordingly, a small credit union facing a lawsuit for a technical violation of the TCPA could essentially be driven out of business for an action such as sending a text message to a group of consumers.

Does it make sense to threaten the existence of one of the safest and most affordable options for consumers to turn to, to right the very minimally offensive wrong of something like receiving a text message? We do not believe it does, and believe that a more reasonable agreement could be reached in arbitration, or another process. Credit unions have a long history of consumer protection, which includes seeking to eliminate regulatory burdens that threaten to make the products and services they offer more expensive or less available. We believe the CFPB's arbitration proposed rule threatens to do this.

A CFPB Arbitration Website Would Primarily Benefit Lawyers Not Consumers

CUNA is also concerned about the CFPB's proposed requirement that companies that use arbitration clauses must submit claims, awards, and other related materials to the CFPB for monitoring and publication on its website. While such requirements would undoubtedly be helpful for trial attorneys seeking to put frivolous class action lawsuits together for the benefit of reaping exorbitant fees, we do not believe there is a significant value for credit union members. To the contrary, we believe it could subject members to privacy and data security violations. Furthermore, we believe this requirement would be duplicative of the CFPB's massive complaint database, which already has several unresolved issues including complaint verification and validation. Truly, the CFPB should spend its time and resources fixing the ongoing issues related to the public facing complaint database.

CUNA Could Support Reforming Abuses in the Arbitration Process, but the Solution is Not a *De facto* Ban on Arbitration

The Dodd-Frank Wall Street Reform and Consumer Protection Act directed the CFPB to study arbitration agreements, with the potential to modify their use. After releasing a study on arbitration it appears that the CFPB's conclusion, rather than making any reforms, to the arbitration process is simply to eliminate all clauses that can stop consumers from joining class

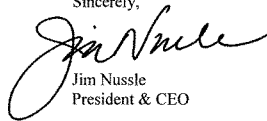
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actions. This seems like yet another missed opportunity to really target any problematic behavior, and instead takes an overly broad approach that completely eliminates an option which, indisputably, can be a much better option than class action litigation for consumers and the economy.

Credit unions strongly support treating consumers fairly as evidenced by the extremely high satisfaction level of our members. However, stacking the cards against credit unions by creating arbitrary regulations, coupled with making it easier for plaintiffs attorneys to target them with frivolous class action litigation, is not helpful for consumers or those working to serve them.

On behalf of America's credit unions, thank you for conducting a hearing on this important issue. We look forward to continuing to work with you on this and other matters of importance to credit unions.

Sincerely,



Jim Nussle
President & CEO

AFR Americans for Financial Reform

May 18, 2016

Dear Representative,

Americans for Financial Reform (AFR)¹ appreciates the opportunity to provide this statement for the record of the House Financial Services Subcommittee on Financial Institutions and Consumer Credit. On May 5, the Consumer Financial Protection Bureau (CFPB) proposed a rule to restore consumers' right to join together to hold corporations accountable when they break the law. The CFPB's proposal would limit the financial industry's use of forced arbitration, a tool to shield corporations from accountability by burying fine print in take-it-or-leave-it contracts to block consumers from challenging predatory practices such as hidden fees, fraud, and other illegal behavior.

This rule is a crucial step to limit big banks' and other financial companies' efforts to escape liability if they break the law. Congressional or industry interference with the CFPB's rulemaking process on forced arbitration would undermine consumer protection for critical financial products and services.

In forced arbitration, consumers lose the right to argue their case before an impartial judge and jury. Instead financial companies are able to hire a private arbitration firm of their choosing to decide the dispute, and consumers have little opportunity to develop evidence or appeal a bad decision. Nearly all forced arbitration clauses rip consumers off by prohibiting participation in class actions – which both bars them from talking about their experiences in arbitration and shields corporate misconduct from public scrutiny.

A week before this rule was proposed, AFR and 163 organizations called on the CFPB to take strong action against forced arbitration (see attached). This coalition includes national organizations as well as local groups representing over 35 states – ranging from consumer advocates like Consumers Union and Public Citizen, to civil rights groups like the NAACP and the National Council of La Raza, to small business coalitions like Main Street Alliance. This diverse array of signers represents the various constituencies whose interests CFPB is charged with protecting, and their message was loud and clear: a strong rule limiting forced arbitration is crucial.

In the years since 2011's landmark *AT&T Mobility LLC v. Concepcion* decision, which held that corporations can use forced arbitration to block consumers from joining class actions even if doing so overrides state law, forced arbitration has become increasingly prevalent. In 2014, 99.9% of mobile wireless service agreements, 98.5% of payday loan contracts, 92% of prepaid card agreements, and 53% of credit card loans included forced arbitration provisions, the vast majority of which also banned consumers from joining together to challenge abusive practices as a class. The ubiquity of arbitration clauses make it virtually impossible for consumers to enforce their rights without opting out of the marketplace entirely.

¹ AFR is a coalition of more than 200 national, state and local groups who have come together to reform the financial industry. Members of our coalition include consumer, civil rights, investor, retiree, community, labor, faith based and business groups.

Before proposing this rule, the CFPB spent three years examining the effect of forced arbitration on consumers in financial services, under the directive of Section 1028(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Section 1028(b) further authorized the CFPB to “prohibit or impose conditions or limitations” on the use of forced arbitration clauses under its jurisdiction if the Bureau finds it in the public interest and for the protection of consumers.

The data from the CFPB’s 728-page study make clear that agency action to eliminate forced arbitration and class action bans is not only appropriate but necessary to protect consumers in the financial marketplace. The CFPB’s study represents the most thorough empirical research to date, examining the use of arbitration agreements in a number of financial markets reaching tens of millions of consumers. Some key findings:

- In 2010 and 2011, only 9% of consumers who brought affirmative claims obtained relief in forced arbitration – the 32 consumers who prevailed recovered an average of 12 cents per dollar claimed.
- In contrast, 93% of companies obtained relief in forced arbitration – recovering an average of 98 cents per dollar claimed.
- Without the option to join together in a class action, only 25 consumers with claims of less than \$1,000 pursued arbitration annually.
- In contrast, consumers received \$2.7 billion of gross relief in class actions from 2008-2012 – \$2.2 billion of which went straight to consumers after attorneys’ fees and litigation costs – with 34 million consumers receiving a cash payment.

While the CFPB’s current proposal does not end all forms of forced arbitration, it is a crucial step to limit big banks’ and other financial companies’ efforts to escape accountability for breaking the law. We urge members of Congress to heed the calls of public interest groups and consumer advocates and allow the CFPB to act on its congressional mandate to restrict the abusive practice of forced arbitration in the public interest and for the protection of consumers.

* * *

Thank you for the opportunity to express AFR’s views on the Consumer Financial Protection Bureau’s proposed arbitration rule. If you have additional questions on these issues, please contact Amanda Werner, Arbitration Campaign Manager with AFR and Public Citizen, at awerner@ourfinancialsecurity.org or 202-973-8004.

Sincerely,

Americans for Financial Reform

April 27, 2016

The Honorable Richard Cordray
 Director
 Consumer Financial Protection Bureau
 1275 First Street NE
 Washington, DC 20002

Dear Director Cordray:

The undersigned organizations commend the Consumer Financial Protection Bureau (“CFPB” or “Bureau”) for moving forward on a rulemaking to address the widespread harm resulting from forced arbitration, which blocks consumers from joining together to seek justice and forces them into individual arbitration. Lenders and other financial services companies use forced arbitration to push consumers out of court and into a private arbitration system that they tilt to favor large financial interests. The CFPB’s empirical findings in its comprehensive and evidence-based report on the use of arbitration clauses unequivocally demonstrate that forced arbitration imposes conditions that restrict consumers’ rights and block their access to courts, giving lenders an effective license to steal.

Few practices are as fundamentally contrary to the public interest as the increasingly widespread use of these “ripoff clauses” that impose forced arbitration in most consumer financial contracts, including credit cards, student loans, debt settlement, credit repair, auto financing, and payday loans. These clauses force consumers into a secretive, unfair system set up by corporations to protect and hide harmful and unlawful corporate behavior. Not only does forced arbitration eliminate the right to jury trial in a civil action, limit discovery, restrict or prohibit publicity, and make meaningful appeal impossible; these clauses also often prohibit consumers from banding together in a class action to hold the company responsible.

The proposed prohibition of class action bans, currently under consideration by the CFPB, is a crucial step to protect consumers against abusive practices. While we urge the Bureau to go further by prohibiting forced arbitration in individual cases as well, we support the proposal to begin shining a light on individual arbitrations through reporting requirements. We also encourage the Bureau to finalize its rule on arbitration as quickly as possible and ensure that the final rule applies to all products and services within its authority.

The CFPB’s “Arbitration Study: Report to Congress, pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act § 1028(a)” verified the prevalence of forced arbitration clauses – including class action bans – in consumer financial contracts and found that this practice impacts tens of millions of consumers. CFPB data leave no doubt that forcing consumers into arbitration effectively eradicates claims, shielding corporate wrongdoers from liability. This data further revealed that only about 600 consumers filed a claim in arbitration each year, while millions more received redress from class actions.

Class action bans in forced arbitration clauses prevent consumers from bringing claims of fraud or other abusive or deceptive practices in financial services, as such claims are often too small for an individual consumer to afford to bring alone. Class actions provide a practical way for consumers who have suffered the same kind of abuse from the same corporate wrongdoer to join together in attempting to hold the financial institution accountable. This kind of action is critically important, not only for enabling those already victimized to obtain justice, but also for deterring bad behavior and preventing harm to other victims.

Consistent with the study's findings, the ability of consumers to seek justice in court, and particularly when they can join their claims together, benefits millions of Americans and also complements public enforcement efforts. Private legal actions by consumers supplement government enforcement under a wide range of consumer protection statutes, such as the Servicemembers Civil Relief Act, the Fair Debt Collections Practices Act, the Fair Credit Reporting Act, the Sherman and Clayton Antitrust Acts, the Truth in Lending Act, and the Equal Credit Opportunity Act. Government enforcers have limited resources, and without the prospect of class action, financial service companies can evade the law far more easily.

It is also clear that consumers typically have no idea they are signing away their right to sue in court when they obtain financial services. As empirical research shows, most consumers are not aware of these clauses, which are buried in the fine print of standard-form contracts. The Bureau's report determined that more than 75 percent of consumers surveyed did not know whether they were subject to forced arbitration in their consumer financial contracts. The CFPB study further confirms that, even when consumers are aware of the clauses, they do not meaningfully understand them. Fewer than 7 percent of those surveyed that are covered by arbitration clauses realized that the clauses restricted their ability to sue in court.

Further, when consumers learn what forced arbitration actually does to their rights, they are outraged by this abusive practice. Last year, 100,000 consumers signed a petition against the five largest banks that use forced arbitration clauses, demanding that they stop.²

The CFPB's rulemaking is in keeping with other recent federal government actions that curb the use of forced arbitration. The CFPB itself implemented a provision of the Dodd-Frank Act that prohibits forced arbitration of disputes related to most mortgage and home equity loans. Congress also banned forced arbitration in transactions with military servicemembers with respect to payday loans, vehicle title loans, and tax refund anticipation loans; auto dealers and automobile and truck manufacturers; livestock and poultry growers; and employees of government defense contractors with Title VII and sexual assault tort claims. In the federal agency context the Centers for Medicare and Medicaid Services is currently considering a ban on forced arbitration in long-term care facility contracts. Most recently, in March, the Department of Education introduced proposals to deny Title IV funding to colleges using forced arbitration as part of its negotiated rulemaking process.

We believe the findings of the CFPB arbitration study offer concrete proof that forced arbitration is causing widespread harm to consumers, and therefore, that it is in the public

² Chris Morran, *Marching Band Delivers Petition To Citi Asking Banks To "Revoke License To Steal,"* CONSUMERIST, Jan. 28, 2015, <http://bit.ly/1wBs3mc>.

interest and in the interest of consumer protection to prohibit or strictly curtail the use of forced arbitration clauses in consumer financial contracts. We commend the CFPB for moving forward on a rulemaking to address the public harm caused by forced arbitration, and we urge the Bureau to use its full statutory authority to restore consumers' right to choose how to resolve disputes with financial institutions under the law.

If you need additional information regarding this letter, please contact Amanda Werner, Arbitration Campaign Manager with Americans for Financial Reform and Public Citizen, at awerner@ourfinancialsecurity.org or (202) 973-8004.

Thank you for considering our views.

National Signatories

AFL-CIO
 AFSCME
 Alliance for a Just Society
 Alliance for Justice
 American Association for Justice
 American Association of State Colleges and Universities
 American Family Voices
 Americans for Financial Reform
 The Bazelon Center for Mental Health Law
 Center for Economic Integrity
 Center for Economic Justice
 Center for Global Policy Solutions
 Center for Justice & Democracy
 Center for Popular Democracy
 Center for Progressive Reform
 Center for Responsible Lending
 Citizen Works
 Committee to Support the Antitrust Laws
 Constitutional Accountability Center
 Consumer Action
 Consumer Federation of America
 Consumer Watchdog
 Consumers for Auto Reliability and Safety
 Consumers Union
 Demos
 Economic Analysis and Research Network (EARN)
 The Employee Rights Advocacy Institute for Law & Policy
 Generation Progress
 Higher Ed, Not Debt
 Homeowners Against Deficient Dwellings

The Institute for College Access & Success (TICAS)
 Institute for Science and Human Values, Inc.
 Jobs with Justice
 Justice in Aging
 The Leadership Conference on Civil and Human Rights
 League of United Latin American Citizens
 Main Street Alliance
 NAACP
 National Association for College Admission Counseling
 National Association of Consumer Advocates
 National Center for Law and Economic Justice
 National Center for Lesbian Rights
 National Center for Transgender Equality
 National Consumer Law Center (on behalf of its low-income clients)
 National Consumer Voice for Quality Long-Term Care
 National Consumers League
 National Council of Jewish Women
 National Council of La Raza
 National Employment Lawyers Association
 National Employment Law Project
 National Fair Housing Alliance
 National LGBTQ Task Force
 National Legal Aid and Defender Association
 National Women's Law Center
 Other 98%
 Privacy Rights Clearinghouse
 Public Citizen
 Public Justice
 Rootstrikers
 SEIU
 Southern Poverty Law Center
 U.S. PIRG
 United Policyholders
 The Woodstock Institute
 Workplace Fairness
 Young Invincibles
 9to5, National Association of Working Women

State and Local Signatories

Arkansans Against Predatory Payday Lending, AR
 Arizona Community Action Association, AZ
 Center for Economic Integrity, AZ
 California Reinvestment Coalition, CA
 California State Student Association, CA
 Center for Public Interest Law, CA

Children's Advocacy Institute, CA
 Consumer Attorneys of California, CA
 Consumer Federation of California, CA
 CourageCampaign.org, CA
 Greenlining Institute, CA
 Housing Resource Center of Monterey County, CA
 Law Foundation of Silicon Valley, CA
 The Utility Reform Network (TURN), CA
 Community Capital Fund, CT
 CT Center for Patient Safety, CT
 Legal Assistance Resource Center of Connecticut, Inc., CT
 The Legal Aid Society of the District of Columbia, DC
 Fair Housing Center of the Greater Palm Beaches, FL
 Florida Alliance for Consumer Protection, FL
 Jacksonville Area Legal Aid, Inc., FL
 Progress Florida, FL
 Habitat for Humanity West Hawaii, GA
 Georgia Watch, GA
 Idaho Art and Graphics, ID
 Center for Economic Progress, IL
 Chicago Consumer Coalition, IL
 Illinois Association for College Admission Counseling, IL
 Catholic Charities of North Louisiana, LA
 Consumer Federation of the SE, LA
 PREACH, LA
 Solomon Temple MB Church, LA
 Consumer Assistance Council, Inc., MA
 Consumer World, MA
 Massachusetts Consumer Council, MA
 Mayor's Office of Consumer Information, MA
 Maryland Consumer Rights Coalition, MD
 Public Justice Center, MD
 Veterans Education Success, MD
 Maine Women's Lobby, ME
 Michigan Association for College Admission Counseling, MI
 Michigan Disability Rights Coalition, MI
 Global Green Initiative, MI
 Ironworkers Local 25 -Detroit, MI
 Michigan Forward, MI
 Progress Michigan, MI
 Minnesota Association for College Admission Counseling, MN
 Communities Creating Opportunity, MO
 Consumers Council of Missouri, MO
 Missourians Organizing for Reform and Empowerment, MO
 Missouri ProVote, MO
 North Carolina Justice Center, NC

Reinvestment Partners, NC
 North Dakota Economic Security and Prosperity Alliance, ND
 Granite State Organizing Project, NH
 Affordable Housing Alliance, NJ
 New Jersey Citizen Action, NJ
 Center for Economic Integrity - New Mexico Office, NM
 Albany County Rural Housing Alliance, Inc., NY
 Bankruptcy Law Center, NY
 Brooklyn Housing and Family Services, Inc., NY
 Central New York Citizens in Action, Inc., NY
 Empire Justice Center, NY
 Hudson River Housing, NY
 JASA Legal Services for the Elderly in Queens, NY
 JEM, Inc., NY
 Keuka Housing Council, Inc., NY
 Long Island Housing Services, Inc., NY
 MFY Legal Services, Inc., NY
 National Coalition for Asian Pacific American Community Development, NY
 New York Lawyers for the Public Interest, NY
 New York Public Interest Research Group, NY
 Pratt Area Community Council, NY
 COHHIO, OH
 Miami Valley Fair Housing Center, Inc., OH
 Neighborhood Housing Services of Greater Cleveland, OH
 Ohio Poverty Law Center, OH
 Policy Matters Ohio, OH
 Oregon Consumer League, OR
 Integra Home Counseling, Inc., PA
 Keystone Progress, PA
 Columbia Consumer Education Council, SC
 South Carolina Appleseed Legal Justice Center, SC
 Tennessee Citizen Action, TN
 New Level Community Development Corp, TN
 Home Owners for Better Building, TX
 Take Back Your Rights PAC, TX
 Texas Consumer Association, TX
 Texas Watch, TX
 Virginia Organizing, VA
 Columbia Legal Services, WA
 Lynch Family Trust, WA
 H & R Properties, WI
 Mountain State Justice, WV
 WV Citizen Action Group, WV
 Potomac and Chesapeake Association for College Admission Counseling
 Western Association for College Admission Counseling



Statement for the Record

Christine Hines, Legislative Director

National Association of Consumer Advocates

U.S. House Financial Services Committee, Subcommittee on Financial Institutions and Consumer Credit

Hearing entitled: "Examining the CFPB's Proposed Rulemaking on Arbitration: Is it in the Public Interest and for the Protection of Consumers?"

May 18, 2016

The National Association of Consumer Advocates (NACA), a nonprofit association of private and public sector attorneys, legal services attorneys, law professors, and law students who have represented hundreds of thousands of consumers victimized by fraudulent, abusive and predatory business practices, appreciates this opportunity to submit this statement for the subcommittee's consideration. As a national organization, NACA's members and their clients are actively engaged in promoting a fair and open marketplace that forcefully protects the rights of consumers, particularly those of modest means.

NACA strongly supports the Consumer Financial Protection Bureau's proposed rule on predispute binding mandatory arbitration (or forced arbitration), issued pursuant to Section 1028(b) of the Dodd-Frank Wall Street Reform and Consumer Protection Act. NACA also joined with 163 public interest organizations on a letter to the CFPB in support of a rule to protect consumers from forced arbitration.¹ The Bureau proposes to limit the harmful impact of forced arbitration clauses by eliminating their most restrictive requirements, class action bans. It also proposes to collect data relating to arbitrations that occur on an individual basis.

Consistent with the findings of the Bureau's comprehensive and meticulous three-year study of forced arbitration, the proposed rule will restore access to remedies for millions of Americans harmed by predatory or illegal practices in the consumer financial marketplace. It will also help to shine a light on the dark unknown of secret individual arbitration and additional details on its impact on consumers.

¹ *NACA Joins 163 Groups Urging Strong CFPB Rule on Forced Arbitration*, April 27, 2016, <http://bit.ly/1srggMI>.

I. Forced arbitration clauses and class action bans suppress consumer claims, avoid accountability.

One of the major takeaways from the Bureau's examination is the stark and now indisputable proof that forced arbitration clauses, and particularly those that bar consumers from participating in class actions, simply eliminate consumer complaints. First, these terms in consumer finance contracts that deny consumers the right to sue and require that disputes be resolved in private arbitration on an individual basis permeate the financial marketplace. It is difficult for ordinary people, that's tens of millions of consumers and even small businesses, to avoid these restrictive, nonnegotiable contract terms when seeking and using financial services.

Second, in financial services, individual consumers typically suffer small-dollar harms, such as predatory and illegal charges and fees, and usurious interest rates, where a consumer cannot practically seek remedies on his or her own. Meaning, it is economically infeasible for an individual consumer who suffers a similar small-dollar harm to take on the cost of an individual arbitration or even small claims court. It is even more alarming, as is often the case, when many others suffer the same harm but similarly are unable to seek remedies on their own.

The Bureau's study provides the evidence. First, it showed that there are few small-dollar claims in arbitration. It found that there were only on average about 8 cases per year involving a debt dispute of \$1,000 or less and only about 25 cases per year involving an affirmative claim of \$1,000 or less.

Meanwhile, the Bureau determined that, on average, roughly 32 million consumers were eligible for relief through class action settlements in federal court each year. In a five-year period, at least 160 million class members were eligible for relief in consumer finance class action settlements, which totaled \$2.7 billion in cash, in-kind relief, expenses, and fees.

Based on irrefutable proof, while class action bans exist and remain prevalent, a company can charge small-dollar illegal fees to hundreds or thousands of its customers, reap millions in illicit profit, and avoid being held accountable for its misconduct. By contrast, consumers' access to remedies for financial services-related harms improves tremendously, when they are able to pursue their common claims together.

II. Availability of class actions vastly improves incentive for responsible corporate behavior.

It is clear that class actions are an efficient and necessary tool to compensate consumers impacted by a widespread practice, but they are also critical to change and curb harmful corporate behavior. Courts have recognized the class action device as a way to deter companies from engaging in risky practices and encourage compliance with consumer protection laws.

For example, a federal court examining Congress' intent for the Truth in Lending Act, stated, "Congress concurred with an earlier conclusion by the Federal Reserve Board that 'potential class action liability was an important encouragement to the voluntary compliance which was so necessary to ensure nation-wide adherence to uniform disclosure' since 'most Truth in Lending violations do not involve actual damages and . . . some meaningful penalty provisions are therefore needed to ensure compliance.'"²

In another example, Judge Richard Posner, discussing the Electronic Fund Transfer Act in a case against an ATM service accused of failing to give proper notice of fees, said: "*But even when as in this case the aggregate claim—the sum of all the class members' claims—is meager, such [class] treatment will often be appropriate. A class action, like litigation in general, has a deterrent as well as a compensatory objective... '[S]ociety may gain from the deterrent effect of financial awards... The deterrent objective of the Electronic Funds Transfer Act is apparent in the provision of statutory damages, since if only actual damages could be awarded, the providers of ATM services ... might have little incentive to comply with the law.'*"³

Similarly, in its proposed rule, the Bureau said that it had preliminarily determined "that increasing compliance incentives would be for the protection of consumers. In other words, the monetary incentives for providers to comply with the law due to the threat of class actions are substantially greater than those due to the threat of consumers bringing individual disputes against providers."

Based on our substantial experience, we agree with the Bureau's conclusion. Simply put, corporations adjust their behavior, avoid risky and illegal practices, and appropriately increase their focus on compliance with laws, to avoid getting sued.

III. State and federal governments repeatedly have acknowledged harm of forced arbitration on the marketplace.

While the discussion over forced arbitration clauses may seem to address private rights and remedies between consumers and financial institutions, a critical public component exists. Forced arbitration harms the marketplace as a whole. State and federal officials have long acknowledged the wider implications of the denial of individuals' legal rights on the public interest and on the general population of consumers.

Over many years, the Supreme Court has expanded its interpretation of the Federal Arbitration Act to permit forced arbitration clauses in nonnegotiable consumer contracts and more recently, to permit prohibitions on class actions in those contracts.⁴ Yet, during that time, Congress has taken numerous steps to protect certain sectors and populations from these provisions:

² *Johnson v. Tele-Cash, Inc.*, 1999 U.S. Dist. LEXIS 20653 (D. Del. Dec. 29, 1999).

³ *Hughes v. Kore of Indiana Enterprise, Inc.* (7th Cir. 2013).

⁴ *AT&T Mobility v. Concepcion* (2011) and *Amer. Exp. v. Italian Colors* (2012).

(a) The Dodd-Frank Act barred forced arbitration in residential mortgages and lines of credit, and prohibited forced arbitration of whistleblower claims under the Sarbanes-Oxley Act of 2002;

(b) Congress has protected auto dealers from forced arbitration in their transactions with auto manufacturers (Pub. L. 107-273, 15 U.S. Code § 1226);

(c) Congress restored choice and rights of livestock and poultry growers in their transactions with big agribusiness (7 U.S. Code § 197c);

(d) Employees of government defense contractors with Title VII and sexual assault tort claims are shielded from forced arbitration (the federal government is finalizing an executive order to similarly protect employees of all federal contractors)(48 CFR 252.222-7006);

(e) Under the Military Lending Act, military members and their dependents cannot be forced into arbitration to resolve disputes arising from a wide range of high-cost loans (payday loans, etc.)(10 U.S.C. 987(e)(3) and (f)(4) and 79 Fed. Reg. 58602).

Before the landmark Supreme Court decision *AT&T Mobility v. Concepcion* (2011), in which the Court permitted companies to bar class actions in forced arbitration clauses, courts interpreting the laws of 19 states had struck down class action bans in take-it-or-leave-it consumer contracts, holding that the restrictive terms were “unconscionable.”⁵ *Concepcion* preempted the states’ laws. Also before *Concepcion*, state attorneys general had submitted amicus briefs in consumer cases, urging courts to ensure that consumers retain their right to band together to pursue claims in court, for the necessary enforcement of laws.⁶

Since then, state attorneys general have called on the CFPB to exercise its authority to issue a rule and restore consumers’ right to pursue private rights of action, and seek remedies for harm caused by corporate misconduct.⁷ In their letter, the state consumer protection chiefs said, “Mandatory pre-dispute arbitration is procedurally unfair to consumers and jeopardizes one of the fundamental rights of Americans; the right to be heard and seek judicial redress for our claims.” The letter continued, “The predictable result of such a situation [forced arbitration clauses and class action bans] is not only unfairness to the harmed consumers, but also a systemic failure to hold accountable those companies who abuse the trust placed in them by consumers.”⁸

⁵ See, e.g., *Feeney v. Dell, Inc.* 908 N.E.2d 753, 762-68 (Mass. 2009) and *Schnuerle v. Insight Communications Co.*, 2010 WL 5129850 (Ky. 2010). *Concepcion* substantially reversed these cases.

⁶ *Felts v. CLK Management, Inc.*, Attorney General Gary K. King’s Amicus Curiae Brief On Behalf of Plaintiff-Appellee Andrea J. Felts, (New Mexico, 2010), <http://bit.ly/22g31ep>.

⁷ Letter from State Attorneys General to Director Richard Cordray, Consumer Financial Protection Bureau, Nov. 19, 2014, <http://1.usa.gov/1xGl6WS>.

⁸ Id.

Other federal agencies similarly have recognized the harm of forced arbitration in sectors under their respective jurisdictions. The Centers for Medicare and Medicaid Services initiated a proposed rulemaking to seek curbs on forced arbitration inserted in nursing home enrollment contracts against their residents.⁹ The Federal Trade Commission exercised its explicit rulemaking authority over the Magnuson-Moss Warranty Act, construing the MMWA as barring forced arbitration provisions covering written warranty contracts with respect to consumer claims brought under the statute.¹⁰ The FTC reaffirmed its position last year.¹¹

These and other decisions by state and federal agencies to consider or call for limits on forced arbitration clearly are spurred by their missions to protect consumers and act in the public interest.

IV. CFPB's rulemaking on forced arbitration is for the protection of consumers and in the public interest.

When Congress created and specifically authorized the Bureau to write a rule to limit or restrict forced arbitration clauses in consumer financial contracts, the country was in the throws of an economic crisis. A crisis that was caused primarily by simple recklessness added with a severe lack of accountability in the financial sector. The CFPB's rulemaking will take a significant step forward in restoring some accountability in consumer financial services. Congress should not only strongly support the Bureau's work on this rulemaking, it should encourage the Bureau to continue monitoring developments and take additional steps, when appropriate, to fully restore access to remedies for consumers harmed by risky and illegal financial practices.

⁹ *Medicare and Medicaid Programs: Reform of Requirements for Long-Term Care Facilities*, 80 Fed. Reg. 42168, July 16, 2015.

¹⁰ See 16 C.F.R. § 703.5; 40 Fed. Reg. 60167, 60210 (Dec. 31, 1975).

¹¹ *Final Action Concerning Review of Interpretations of Magnuson-Moss Warranty Act; Rule Governing Disclosure of Written Consumer Product Warranty Terms and Conditions; Rule Governing Pre-Sale Availability of Written Warranty Terms; Rule Governing Informal Dispute Settlement Procedures; and Guides for the Advertising of Warranties and Guarantees*, 80 Fed. Reg. 42010, July 20, 2015.



215 Pennsylvania Avenue, SE • Washington, DC 20003 • 202/588-1000 • www.citizen.org

May 18, 2016

Dear Representative,

Public Citizen submits this statement for the record to the House Financial Services Subcommittee on Financial Institutions and Consumer Credit to express our strong support for the CFPB proposed rule regulating the use of forced arbitration clauses in consumer financial contracts.¹ On May 5, the Consumer Financial Protection Bureau (CFPB) proposed a rule to limit the financial industry's use of forced arbitration clauses that bar consumers from filing or participating in a class action. The proposed rule is transformative for consumers: lifting the class action bans imposed on consumers by big banks and other financial market players finally gives consumers a leg up to recover money stolen from them when cheated by widespread illegal conduct, such as illegal fees, fraud, and other deceptive or abusive behavior that violates consumer protection laws. The proposal also introduces much needed disclosure to regulators by requiring covered financial institutions to submit arbitration records to the CFPB arbitral records so the bureau can further evaluate the impact of forced arbitration clauses on consumers who pursue claims in arbitration individually.

This rule is an exceptionally important consumer protection measure that will protect Americans from unscrupulous and illegal activity by financial institutions. No longer will these entities be able to shield themselves from liability by limiting private enforcement of consumer protection laws and hiding behind secretive arbitration proceedings when they defraud American consumers.

The CFPB issued the rule pursuant to a statutory directive imposed by this body. Section 1028 of the Dodd-Frank Wall Street Reform and Consumer Protection Act expressly directs the Bureau to conduct a study of the issue and to adopt a regulation "to prohibit or impose conditions or limitations on" the use of binding pre-dispute arbitration clauses in consumer contracts for financial goods and services.² The financial products and services covered by this rule are used by hundreds of millions of Americans, and include products and services such as checking accounts, credit cards, student loans, and payday loans among other financial tools. Any attempt to intervene or thwart this rule would be a loss for many of your constituents.

¹ Public Citizen is a national non-profit organization with more than 400,000 members and supporters. We represent the public interest through lobbying, litigation, administrative advocacy, research and public education on a broad range of issues including consumer rights in the marketplace, product safety, worker rights, workplace safety, financial regulation, safe and affordable health care, campaign finance reform and government ethics, fair trade, climate change and corporate and government accountability.

² Public Law 111-223.

Contrary to industry assertions, it is widely understood and well-documented that forced arbitration is anti-consumer and weighs in favor of corporations. Class action bans in particular are intended to make it harder for consumers to recover money from lawbreaking companies, because these players know that forcing individuals to pursue claims individually is less economically feasible, especially when claim amounts are less than the amount it would cost to pursue the claim in arbitration as is often the case. In forced arbitration, consumers lose their Seventh Amendment right to a jury trial. Discovery rules do not apply and there is little opportunity to present evidence, so claimants who are trying to prove their cases are handcuffed. The CFPB study also revealed that class actions bans are contained in virtually every consumer contract across the six consumer financial markets studied.

The question posed in the title of today's hearing – whether the CFPB's proposed arbitration rule is in the public interest and protects consumers – has been answered by 164 consumer groups, civil rights organizations, student advocates, and public interest lawyers, which called on the CFPB to take strong action against forced arbitration.³ Industry representatives claim that arbitration is more efficient and cost-effective for consumers – this is farfetched. While virtually all consumer advocates disagree, if arbitration was beneficial to consumers there would be no reason to force consumers to arbitrate if it were really the better option for them. And by including class action bans, forced arbitration clauses simply eliminate consumer claims against financial service providers.⁴ The CFPB Study amply demonstrates how forced arbitration benefits companies over consumers with several major findings –

- Consumers are almost always unaware that their financial contracts include forced arbitration clauses. Fewer than 7% of consumers surveyed by the CFPB realized that the clauses restricted their ability to sue in court.
- In 2010 and 2011, consumers with affirmative claims against financial institutions received relief in only 9 percent of the time in arbitrations. On the other hand, when corporations went after consumers, the corporation won in 93 percent of arbitrations.
- Even when consumers won in arbitration, they got on average only 12 cents on every dollar they claimed. Compare this to arbitration awards for corporations, which won 98 cents of every dollar claimed.
- Big business is a repeat player in forced arbitration – they were responsible for more than 80% of all arbitration filings in 2010 and 2011.
- Consumers failed to obtain relief through forced arbitration via federal consumer protection laws. The CFPB found that when consumers attempt to obtain relief through the three most commonly-asserted consumer protection laws – the Fair Credit Reporting Act, Truth in Lending Act, and the Fair Debt Collection Practices Act – they rarely result in an arbitrator providing relief to consumers.

³ See Letter from 164 Groups Urging the CFPB to Take Strong Action on Arbitration, Apr. 27, 2016, *available at* <http://ourfinancialsecurity.org/wp-content/uploads/2016/04/04.27.16-FINAL-Coalition-Sign-On-Letter-to-CFPB.pdf>.

⁴ See Report by Pubic Citizen, Justice Denied One Year Later: The Harms to Consumers from the Supreme Court's *Concepcion* Decision Are Plainly Evident, *available at* <http://www.citizen.org/documents/concepcion-anniversary-justice-denied-report.pdf>.

- Consumers can rarely appeal forced arbitration decisions, and are almost always prohibited from forming a class. From 2010 to 2012, the CFPB found only four consumer appeals, no company appeals, and only two class arbitrations.
- Consumers get significantly more relief through class actions. Of the settlements the CFPB studied, the total amount of gross relief was \$2.7 billion. This includes cash relief of \$2 billion and in-kind relief of \$644 million.

The data is in and the conclusions difficult to overcome: forced arbitration rip-off consumers. Given the mountain of evidence provided by the CFPB study, the more obvious reason for why industry opposes this rule is that they simply do not believe in accountability or liability when they break the law. We urge the Committee to support the CFPB in its mission to protect the American people from the worst practices by big business.

* * *

Thank you for the opportunity to express Public Citizen's views on the CFPB's proposed arbitration rule. If you have additional questions on these issues, please contact Sonia Gill, Counsel for Public Citizen's Congress Watch division, at sgill@citizen.org or 202-454-5135.

Sincerely,

Public Citizen



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Statement of the Electronic Transactions Association

United States House of Representatives

Committee on Financial Services

Subcommittee on Financial Institutions and Consumer Credit

"Examining the CFPB's Proposed Rulemaking on Arbitration: Is it in the Public Interest and for the Protection of Consumers?"

Wednesday, May 18, 2016

In anticipation of the House Committee on Financial Services Subcommittee on Financial Institutions and Consumer Credit hearing on May 18, 2016, the Electronic Transactions Association (ETA) submits the following statement for the hearing record. ETA is the leading trade association for the payments industry; it represents more than 500 companies that provide payment processing services including card networks, financial institutions, processors, manufacturers, independent sales organizations, and technology companies. ETA's comments are intended to assist in the Committee's examination of the value of pre-dispute arbitration clauses for consumers and the likely effects of regulation, like the Consumer Financial Protection Bureau's ("CFPB") recent Notice of Proposed Rulemaking (NPRM) restricting the use of such clauses.

Historically, arbitration agreements have been supported by the federal government and the U.S. Supreme Court. Specifically, the Federal Arbitration Act of 1925 established a strong federal policy in favor of arbitration and the U.S. Supreme Court has upheld the broad application and enforceability of arbitration agreements in a long series of cases, including several in the last three years.

Arbitration has many advantages for consumers in resolving complaints: 1) it is quick, taking months instead of years; and 2) it is relatively inexpensive, avoiding the need to incur costly legal fees to pursue a law suit. In the end, arbitration is simpler and more cost-efficient for all parties involved.

Dodd-Frank required the CFPB to conduct a study on arbitration as a prerequisite to any rulemaking regulating the use of arbitration agreements in consumer financial agreements. The CFPB was authorized to engage in such rulemaking only "if the Bureau finds that such a prohibition or imposition of conditions or limitations is in the public interest and for the protection of consumers," as reflected by its study.

ETA has concerns about the manner in which the CFPB's *Arbitration Study* was conducted, including the lack of public access to the data underlying the study and the subsequent March 2015 Arbitration Report to Congress. One significant finding that the CFPB did make, however, is that dispute resolution mechanisms in credit card agreements play a limited role, if any at all, in consumers' decisions to obtain or use a particular credit card. In viewing the lack of importance that consumers attach to dispute resolution provisions in financial services agreements, it appears that the CFPB may be unfairly

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attempting to restrict the use of pre-dispute arbitration provisions especially in light of its finding that the evidence is inconclusive as to whether individual arbitration conducted is superior or inferior to individual litigation in terms of remediating consumer harm. The study did show, however, that the average consumer financial recovery was far higher in arbitration than it was in class actions.

ETA also has concerns about the impact that a substantial increase of class action lawsuits will have on small and medium-sized businesses as well as on an already-overburdened federal court system as a result of the elimination of pre-dispute arbitration clauses. The CFPB's study reflects that consumers received an average recovery of just \$32.35 in class action benefits, while their attorneys pocketed more than \$1.2 million. Further, consumers received no recovery at all in at least 60% of the class actions studied by the CFPB.

ETA believes expanding the number of costly class actions and prohibiting the use of arbitrations, where consumers have fared better, is not "in the public interest and for the protection of consumers." Instead, the Bureau should focus its efforts on increasing consumers' awareness of their dispute resolution rights, maintaining a swift and cost-effective dispute resolution system, and avoiding the increased costs consumers would inevitably pay as a result of more class actions. The CFPB's proposal to restrict the use of pre-dispute arbitration clauses in consumer financial agreements would limit dispute resolution options for consumers and should be reconsidered by the agency before any final rule is promulgated.

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**“Examining the CFPB’s Proposed Rulemaking on Arbitration: Is it in the Public Interest
and for the Protection of Consumers”
House Financial Services Committee
Subcommittee on Financial Institutions and Consumer Credit**

**U.S. House of Representatives
May 18, 2016**

**Steve Jordan
Chief Executive Officer
National Independent Automobile Dealers Association**

**Statement for the Record
Submitted May 25, 2016**

Mr. Chairman and Members of the House Financial Services Committee’s Subcommittee on Financial Institutions and Consumer Credit, my name is Steve Jordan, Chief Executive Officer of the National Independent Automobile Dealers Association (“NIADA”) headquartered in Arlington, Texas. On behalf of the Association, I appreciate the opportunity to submit this statement for the record regarding the Subcommittee’s May 18th hearing entitled “Examining the CFPB’s Proposed Rulemaking on Arbitration: Is it in the Public Interest and for the Protection of Consumers.”

For 70 years, the NIADA has represented the interests of the nearly 38,000 independent automobile dealers who own dealerships across America, not affiliated with a manufacturer. NIADA and its nearly 16,000 members subscribe to a Code of Ethics that emphasizes honor, integrity and fair dealing. NIADA members espouse the highest professional and ethical standards and are committed to ensuring a fair marketplace for both consumers and dealers.

NIADA members embody the spirit of American entrepreneurship, and as a result NIADA is dedicated to ensuring the success of small businesses. More than 40 percent of NIADA’s dealer members have been in business for more than 20 years, and almost 50 percent have five or fewer

employees. They are the small car store that survives in the best of times and the worst of times because they are a part of their communities as fathers, mothers, Better Business Bureau members, Chamber of Commerce members, city councilmen, school board members, churchgoers, youth organization sponsors and coaches, and task force members who look for ways to make our cities and our towns better places to live.

On May 5th, the CFPB released a proposed rule that would prohibit certain entities, including those engaged in automotive finance such as automobile dealers engaged in buy here pay here financing, from using pre-dispute arbitration agreements that contain a class action waiver. The proposed rule followed the CFPB's study of the use of arbitration agreements mandated by Section 1028 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank").

As an Association, NIADA commends you and the Subcommittee for holding this important hearing to consider this proposed rule and its impacts both on American consumers and businesses. Arbitration has proven to be a faster, less expensive, and more effective means of resolving consumer disputes than class action lawsuits. Likewise, consumers that receive an award in arbitration almost always receive more than they would in a class action lawsuit, a point that is proven in the CFPB's own study. The primary beneficiary in class action litigation is not consumers, but the trial lawyers pursuing those claims. If the CFPB's ultimate goal is to give consumers their day in court, padding the pockets of trial lawyers does not further that objective.

NIADA agrees with those that have commented previously on the flaws in the CFPB's study. The study failed to consider the consumer's experiences in going through the arbitration process. How can the CFPB impose a rule prohibiting the use of arbitration agreements with class action waivers if the consumers are more satisfied with the speed, efficiency, and final judgment in arbitration than in class action lawsuits? Additional empirical evidence should be gathered on that issue alone.

Equally troubling to NIADA is the narrow focus of the financial products actually examined in the report. The report contains virtually no information on automotive financing and what is contained in there appears to misconstrue the financial product most typically involved in automotive financing as a loan as opposed to a retail installment sales contract. This lack of understanding of the product make the study's findings murky at best.

Moreover, NIADA is concerned and frustrated that the CFPB is making assumptions that the disclosure of arbitration agreements is the same in all consumer financial products. It appears that the CFPB operates from the premise that arbitration agreements in automotive financing are buried in the fine print on the back of a lengthy contract that consumers cannot easily find.

NIADA is not in a position to comment whether that is true with other consumer financial products, but it is not a common practice in automotive financing. Generally, automobile dealers that elect to use an arbitration agreement in their sales and financing process provide the consumers with a separate document that contains nothing but the terms of the arbitration agreement. The font is large enough to be readable and understandable. This separate document contains a clear and conspicuous disclosure that the consumer is giving up certain rights (such as

the right to participate in a class action) and has a signature line that the consumer is required to sign specifically agreeing to those terms.

By providing a separate arbitration document, dealers are being open and transparent of what the consumer is agreeing to with respect to arbitration. Presumably, the CFPB exists to ensure transparency in the marketplace. Rather than drive arbitration out of the marketplace, perhaps the CFPB should consider a rule that recognizes the benefits of arbitration but ensures that a transparent process is in place for the consumer when agreeing to pre-dispute arbitration.

If the proposed rule moves forward, the costs businesses will be forced to bear in defending class actions, particularly meritless suits, will raise the cost of financial products to consumers and could impose an insurmountable financial burden on small business that they would be forced to shutter their business. NIADA has had several of its dealer members enveloped in class action suits that ultimately proved to be meritless, but nonetheless required them to spend nearly \$1 million in defense costs before that determination was made. Small businesses simply cannot afford to bear these costs.

Ultimately, costs that businesses are forced to bear, whether those costs be imposed as a result of regulation or litigation, will be passed on to consumers. In the case of customers of buy here pay here dealers who may be credit challenged, the increase costs of a motor vehicle and the associated costs of credit associated with the financing of that vehicle may ultimately prove to be too much for them. Where does that customer then turn for financing to purchase a motor vehicle?

Through one of its buy here pay here dealer members, NIADA was asked to participate in the CFPB's Small Business Advisory Review Panel that was convened prior to the release of this proposed rule. NIADA shared these concerns with the CFPB as part of that process. Unfortunately, the CFPB elected to ignore them. Nevertheless, NIADA will continue to engage the CFPB in the discussions that will provide the Bureau with needed information about the industry so they can make informed, open decisions consistent with and limited to its statutory mandate.

Dodd-Frank requires that any action the CFPB takes on arbitration agreements must be consistent with the study the CFPB conducted. The bottom line is that the CFPB's proposed rule is not consistent with their own study. There simply is no evidence in the report on which the CFPB can rationally rely to justify a ban on class action waivers.

We hope that the Bureau will engage in substantive discussions with interested parties from the automotive finance industry and other financial sectors on meaningful solutions that address the CFPB's concerns with pre-dispute arbitration while recognizing the legitimate benefits of arbitration on both consumers and businesses.

NIADA also encourages the CFPB to pull the proposed rule, reexamine and supplement its study with a comprehensive look at arbitration from all perspectives including how pre-dispute arbitration agreements are disclosed in the myriad of consumer financial products. If the CFPB fails to act on its own accord, NIADA encourages Congressional action that would require a

more thorough and complete study and hearings to determine if the results of the revised study and any proposed rule are consistent as required by Section 1028.

NIADA stands ready to assist the Committee in any way we can.

At Your Service,

A handwritten signature in black ink, appearing to read "Steve Jordan".

Steve Jordan
NIADA
CEO

